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Politics this week

Jun 24th 2004
From The Economist print edition

A constitution for the EU

Reuters

The **European Union** summit in Brussels ended with agreement on a new EU constitution, but not on the choice of a new president for the European Commission. Bertie Ahern, the Irish prime minister who presided over the summit, hopes to settle on a new name before Ireland's EU presidency ends on June 30th.

See article

Portugal and Spain confirmed that they will hold referendums to approve the new **EU constitution**. They join eight others planning votes. The most difficult are likely to be those in Britain and Poland.

Suspected rebels from **Chechnya** swept through neighbouring Ingushetia, aiming especially at the former capital Nazran, and killing almost 100 people, including several top Ingush officials.

See article

The **Italian** prime minister, Silvio Berlusconi, blamed the poor score of his Forza Italia party in recent elections on ballot-rigging by the centre-left opposition.

Handover in Iraq

As the formal handover from American to Iraqi rule on June 30th approaches, insurgents increased their efforts to disrupt the process, with co-ordinated attacks on several towns in the Sunni triangle near Baghdad. Meanwhile, 40 people were killed in a series of car-bomb attacks in the northern city of Mosul. The incoming prime minister, **Iyad Allawi**, promised ruthless measures to restore order.

See article

A 33-year-old South Korean hostage was beheaded by terrorists demanding the withdrawal of South Korean troops from **Iraq**. South Korea has 600 troops in the country and confirmed plans to send another 3,000 starting in August.

See article

After an American engineer had been kidnapped and later beheaded by al-Qaeda, police in **Saudi Arabia** killed four of the terrorists suspected of involvement, including al-Qaeda's supposed leader in the kingdom, Abdel Aziz al-Muqrin. Crown Prince Abdullah gave remaining insurgents a month in which to surrender or face the consequences.

See article

Anti-terrorist forces had a similar success in **Algeria**, killing seven fighters of the country's most durable Islamist terror group, the Salafist Group for Preaching and Combat, including its leader. Police also rounded up terrorist cells in Bahrain and Morocco, while the Egyptian authorities said they had arrested 25 *jihadis* who had planned to kill security officials and attack government buildings.

Iranian Revolutionary Guards captured three vessels and eight British servicemen whom they accused of straying into Iran's waters in the Shatt al-Arab waterway between Iran and Iraq. They were released three days later.

Egypt's 76-year-old president, **Hosni Mubarak**, was said to be recovering in a hospital in Munich after an operation on his back.

Israel's defence minister, Shaul Mofaz, said that actual and attempted suicide attacks by Palestinians had fallen sharply, partly thanks to the security barrier between Israel and the Palestinians' territory. There have been no suicide-bombings since March; last year there were 20 such attacks. Some 2,000 terrorist suspects have been arrested this year.

The UN reported a resurgence of the **polio** virus across Africa, reaching ten previously polio-free countries. This followed the suspension of polio vaccination in parts of northern Nigeria, after some imams had claimed the vaccine was part of a western plot to sterilise Muslims.

See article

Legally binding?

In a bid to mute criticism about its treatment of prisoners abroad, the White House released hundreds of pages of internal administration memos that set out the legal advice it had received on **interrogating suspects** in the war on terror.

See article

America was forced to withdraw a Security Council resolution that would have exempted American UN-peacekeeping troops from prosecution by the **International Criminal Court**. It had won immunity in previous years, but the prisoner scandal at Abu Ghraib strengthened opposition from other members of the council.

The State Department released a corrected version of its annual report on worldwide **terrorism**. A previous report claiming that terrorist activity was at its lowest level for over 30 years had to be withdrawn amid much embarrassment. Over 3,600 people were wounded in terrorist acts last year, a big increase on 2002.

The Republican governor of **Connecticut** resigned amid allegations of corruption and facing possible impeachment. Federal and state authorities are investigating whether John Rowland took gifts in return for political favours. He denies the accusations.

See article

Ralph Nader selected Peter Camejo, a **Green Party** activist, as his vice-presidential running mate. Mr Camejo came fourth in California's recall election last October.

Arnold Schwarzenegger signed a deal with five Indian tribes in **California** that allows them to expand casino operations on their land. The agreement will earn $1 billion for the cash-strapped state this year but the governor says he will oppose further attempts to expand casino gambling.

Tension mounts

As a close-fought election campaign drew to a close, **Canada's** prime minister, Paul Martin, and his Conservative opponent, Stephen Harper, both concentrated their efforts in Ontario, the most populous province. Opinion polls pointed to a minority government—but whose?

See article

After the Senate had rejected President Luiz Inácio Lula da Silva's proposal for a rise in **Brazil's** minimum wage, substituting a higher one, the lower house restored the original rise. The episode showed

that the government's grip on Congress is fraying.

See article

Peru's president promulgated an opposition-inspired law to levy royalties of 1-3% of sales on some mining companies. Anglo American, a mining giant, immediately pulled out of an auction to develop a large copper deposit.

Friends again

The foreign ministers of **Pakistan** and **India** met for the first time since India's new Congress-led government took office. Both countries renewed a ban on nuclear-weapons testing and set up a crisis hotline.

See article

A new round of six-party talks aimed at resolving the crisis over **North Korea's** nuclear-weapons programme opened in Beijing.

Six weeks after elections in the **Philippines**, the count was finally completed, confirming the re-election of Gloria Arroyo as president. The opposition claims the poll was marred by irregularities.

See article

AFP

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Business this week

Jun 24th 2004
From The Economist print edition

Wal-Mart accused

An American judge gave the go-ahead to a class-action lawsuit by as many as 1.6m former employees of **Wal-Mart**. The case, first filed in 2001 by six workers, charges that the firm denied females equal pay and promotion. Wal-Mart's shares were dented; the case could cost it billions of dollars.

See article

The Barclay brothers agreed to buy the **Telegraph Group,** publishers of the *Daily Telegraph* and its Sunday sister title, for £665m ($1.2 billion). The reclusive British businessmen have stalked the paper since it was put up for sale by Hollinger International. Lord Black, a controlling stakeholder of Hollinger International and its former boss, threatened to block the sale.

See article

Jean-Marie Messier, a former chief executive of Vivendi Universal, was detained for two days by French police investigating share manipulation during his time as boss of the media giant. It is alleged that he broke stockmarket rules with a *euro*1 billion ($925m) share buy-back in 2001 and issued misleading information about the firm's finances.

See article

American regulators gave the go-ahead for a merger between the American interests of **British American Tobacco** and **R.J. Reynolds**. The $3 billion deal will create Reynolds America with a share of over 30% of the American market. BAT's shares surged—the deal protects it from future litigation in America.

In the bedroom

America imposed anti-dumping tariffs of up to 198% on Chinese wooden **bedroom furniture** (though most exporters will pay 24%) after a complaint by American manufacturers. America's furniture retailers protested. So did China's furniture industry, which denied the charges.

Loews Cineplex changed hands for the second time in three years. Onex, a Canadian buy-out firm that bought the world's third-largest cinema chain for $850m in 2001, accepted an offer of C$2 billion ($1.5 billion) from a consortium led by Bain Capital.

The world's biggest online auctioneer, **eBay**, entered another huge and potentially lucrative market by paying some $50m for Baazee.com, its largest clone in India. Last year, eBay used the same technique when it bought EachNet, its biggest rival in China.

America's leading internet portals opened a new front in the war on **spam**. They proposed better e-mail authentication and want service providers to detect and shut off “zombies”—computers that are hijacked by spammers and unwittingly send out millions of spam messages. Meanwhile, an employee of America Online was arrested on charges that he had sold the e-mail addresses of the firm's 92m customers to spammers.

United Airlines was forced to cut its request for a federal-loan guarantee after a plea for $1.6 billion was rejected. The bankrupt carrier asked instead for $1.1 billion, and said it would seek more private

cash and cut costs further. Some suggest that United's fortunes have revived to the extent that it doesn't need a handout.

Italy's government said that it would guarantee a short-term loan for **Alitalia**. But the EU responded that it would only permit the loan to the national carrier if it conformed with “usual market conditions”.

Southern comfort

Consolidation among America's banks pressed ahead. **Wachovia** agreed to pay $14.3 billion to acquire **SouthTrust**. The deal will improve the coverage of America's fourth-largest bank by assets in the South, particularly Texas, Florida and Georgia.

HSBC made further inroads into China's booming banking market. It agreed to take up to a 20% stake in Shanghai-based **Bank of Communications** for a rumoured $1 billion.

Morgan Stanley announced that profits for the latest quarter had more than doubled compared with a year ago to $1.2 billion. The Wall Street giant did particularly well from investment banking and share and bond trading. **Goldman Sachs's** profits increased by 71% to $1.2 billion for much the same reasons.

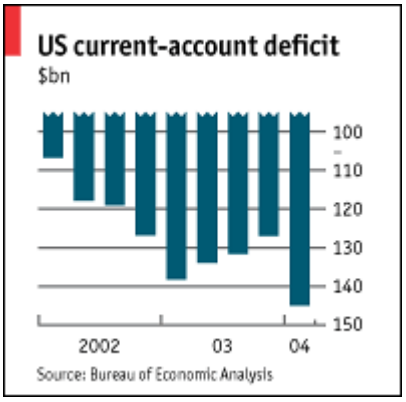
America's SEC introduced new governance rules for **mutual-fund managers,** including a strict requirement for independent directors. But the measures caused a row, with two of five commissioners publicly dissenting. More rules for the troubled industry remain under debate.

See article

The trade gap grows

America's **current-account deficit** widened to a record $144.9 billion in the first quarter—5.1% of GDP—as the country's taste for imports outstripped burgeoning export growth. Alan Greenspan sounded unperturbed during his Senate confirmation hearing for a further term as chairman of the Federal Reserve: “market forces will gradually adjust the imbalances,” he said reassuringly.

See article



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Iraq

Enter Iyad Allawi

Jun 24th 2004
From The Economist print edition

America must give back as much power to Iraqis as it can, after June 30th

Getty

Get article background

AT THE end of this month, America's proconsul in Iraq, Paul Bremer, will fly away from a land of bombs and bullets, doubtless relieved to be still alive. Amid much fanfare, an Iraqi prime minister and president, albeit of a temporary and appointed kind, will proclaim themselves to be in charge; indeed, eagerly jumping the gun, they have already done so.

Iyad Allawi, a hardy long-time exile who is a secular-minded Shia Muslim, has already snatched the reins of government, while Ghazi al-Yawar, the scion of a powerful Sunni tribe that straddles the border with both Saudi Arabia and Syria, is ensconced as president-to-be (see article). The hope is that a swelling majority of Iraqis, seeing control of their country reverting to their compatriots, will rally to the new order, help it crush the vicious and still rampant insurgency, and so gradually let Iraq reach a state of minimal normality in which a patchy peace, a measure of prosperity and a modicum of political civility if not full-fledged democracy can prevail. Mr Allawi should then be able, next January, to oversee a general election that ushers in a government indisputably chosen by the people, which can then start to slough off the help—call it the yoke, if you will—of the foreigners who so brusquely invaded the country some two years before.

To begin with, little may change on the ground after June 30th. It will still, in the eyes of most Iraqis, remain an occupation as long as the American army, now 140,000-strong and due to stay at that level, is still in place. The Americans will continue to kill Iraqis, no doubt some of them civilians as well as insurgents. The violence may not abate. Moreover, Mr Allawi was picked by the Americans after long cosseting by the CIA. The Americans have not even agreed to hand over their prisoners to Iraqis. Though the proconsul will give way to an ambassador, the latter may perform many of the same functions more discreetly. Iraq will remain a conquered land, with Iraqis accusing the infidel of still defiling the nation and its holy places by the mere fact of his clod-hopping presence.

So what's new?

But some big things will change. True, the harsh reality of America's visible force of arms will not alter from one day to the next. However, Mr Allawi has stated very clearly that if his government so wishes, it will tell the Americans to go home—and they have stated, no less clearly, that they will do so if asked, however unlikely that now appears. In any event, the new and more compelling legal fact, underpinned by the UN Security Council's resolution a fortnight ago, is that the Americans and their foreign allies are no longer there thanks only to an order of America's president.

This is not just semantic. For sure, the Americans will still be fighting to impose order on behalf of the new America-blessed regime. But, unlike the Coalition Provisional Authority that has been ruling Iraq for the past year, the incoming regime is an Iraqi one with executive powers endorsed unanimously in the UN's Security Council, approved by virtually all the countries of the Middle East and in the Muslim world. Above all—though this is unprovable—the early evidence suggests that most Iraqis, however warily, are willing to give it a fair wind. What they want above anything else—way above democracy, it must be admitted—is peace. If Mr Allawi can use an iron fist to achieve that, they are very likely to back him.

There is not much time, which is why he has, quite sensibly, been so quick to grab the trappings of power so ostentatiously. He knows his power is qualified by a need to acquiesce in the Americans' presence until he or his successors can dispense with their military services. It will be hard to shake off the perception of occupation. Forging a genuine partnership instead will be hard. The UN's formula whereby Iraqis have strategic control over all armed forces in Iraq but leave operational control to the American-led multinational force is workable, though there are sure to be times when diplomacy and compromise will be needed to draw that fine distinction. Mr Allawi has already shown common sense in his handling of the many militias owing allegiance to Iraq's various political groups and by letting many soldiers and civil servants who served Saddam Hussein return to the fold. Under the guidance of the UN's envoy, Lakhdar Brahimi, he would also be wise to let as wide a range of Iraqis as possible attend next month's national conference, provided that everyone who comes has agreed to eschew terror.

It won't all happen overnight

There are areas, however, where it will be necessary to share power with the Americans for a bit longer. The $18.4 billion promised by Congress for Iraq's reconstruction should not be dispensed without some outside oversight. And the judicial status of the most venal detainees, not least that of Mr Hussein, cannot sensibly be determined until the Iraqis have a revamped judicial system in place. In any event, it is reasonable to defer the most momentous and delicate judicial decisions until a government has been elected by the Iraqi people and perhaps also until, later next year, they are due to have endorsed a new constitution enshrining a new judicial order.

The handover in a few days is partly symbolic, partly legal, partly substantive. It would plainly be misleading to call it total. But most of all it marks a psychological moment.

Mr Allawi's chance to seize it may last only a month or two. The momentum behind him, such as it is, could fizzle fast. Many Iraqis, understandably frightened, are waiting to see which way to jump. The Americans will not go away just yet: it would be shameful if they were to do so before the new order has had a chance to take hold. It is desirable, too, that other foreign governments under pressure to bolt—South Korea's, Japan's and Ukraine's, to name a few—stay firmly put. Down the road, NATO as well as the UN may have a valuable part to play. But, most important of all, America must give Mr Allawi his head, resisting the temptation to second-guess him, let alone to treat him like a puppet. Only by displaying his own independence can he persuade enough Iraqis that it is worth the risk of backing him against the men of violence and chaos.

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European Union

The right verdict on the constitution

Jun 24th 2004
From The Economist print edition

European voters should reject the new constitutional treaty and demand something better

THE task of agreeing a new constitutional treaty for the European Union with 25 countries around the table, all with their own interests and aims, was no doubt a difficult one. Compromise, fudge and imperfection were inevitable. The text that European governments ended up with on June 18th may be, as they say, the best that could be done in such circumstances. Fortunately, however, there is now a chance for those circumstances to be changed: at least ten countries will put the new treaty to their voters in referendums, while the others seek to ratify it solely through their parliaments. Those voters would do themselves, and the European Union, a great service if they were to reject this treaty and jolt governments into coming up with a better version.

Some European politicians and EU devotees have argued that the consequences of a rejection would be catastrophic. That is hyperbole. It might be true that if merely one country out of 25—Britain, say—were to vote no, the situation would be awkward for all concerned. Yet that can be dealt with when and if it occurs (Britain's referendum may well not take place until 2006, the last or nearly last of all the polls). It would be bizarre indeed—unconstitutional even—if governments were to be holding referendums in which only one outcome is deemed acceptable. If you can't take no for an answer, why ask the question? The European Union badly needs more popular legitimacy, as the big anti-incumbent votes and quite sizeable anti-EU votes in this month's European Parliament elections showed. And the big flaw in the proposed constitutional treaty is that it does little or nothing to make Europeans likelier to feel comfortable with the whole enterprise.

Checks, balances and brakes

Regular readers, and offended Europhiles, will recall that when the first draft of this proposed constitution was unveiled in June last year, we recommended (see article) that governments should throw it in the wastepaper bin and start again. Unaccountably, European leaders failed to take our advice. Partly, perhaps, this was because so much time had already been invested in producing that draft, but mainly it was because the treaty does bring some real improvements to the EU—for governments. For the people they serve, however, it does not.

This whole exercise, it should be noted, was supposedly intended to bring the Union closer to its citizens. The so-called Laeken declaration of December 2001, which launched the process of writing a new constitution to replace the existing treaties, talked of popular concerns about too many powers being exercised at European rather than national level, about the lack of democratic scrutiny, and about European institutions and practices being rigid and hard to understand. In fact, however, the new constitutional treaty focuses on a genuine but quite different problem: how to make decision-making easier in an enlarged EU.

If you measure the new treaty against that problem alone, it is a success: a clear improvement on the previous arrangements (see article). The new voting system is fairer and more workable than the absurd formula set up in the Nice treaty of 2001; national vetoes have been removed from several areas; the Union's executive, the European Commission, will eventually (by 2014) have fewer commissioners and thus be less top-heavy; meetings of member governments, the European Council, will be presided over by one person for two-and-a-half years rather than a different country every six months; the Union will

have one common representative for foreign policy rather than two, as now.

But the point of a constitution, or even of a constitutional treaty, as many European leaders now prefer to call it, is not simply to make the process of government easier. In some ways, just the reverse: it is to make sure that government happens under clear rules and constraints, so that it is hard for it to act and evolve in ways that citizens find unacceptable. Otherwise, effectiveness may be achieved at the expense of popular legitimacy and, ultimately, provoke a backlash. That is where Europe's new constitution fails.

For starters, the new treaty is little easier to understand than its predecessors; nor, overall, are the new institutional arrangements. It was probably always hopeless to expect something that could be recited in schools, however. Much more important is the fact that the new treaty does nothing to provide citizens with any sense of control over the process of European government or the evolution of the EU.

Contrary to Laeken's aspirations, no powers have been repatriated. Protections for “subsidiarity”—ensuring that issues are dealt with at the most appropriate level—are weak at best, non-existent at worst: national parliaments are invited to speak up if they think subsidiarity has been flouted, but the European Commission is merely obliged to take note. A procedure known as the “emergency brake” will now allow governments that are uncomfortable with EU measures in social security or criminal justice to opt out of them, but the provision is so vague that it is unclear how it will work. And the European Court of Justice may have been given a more powerful role in coming decades in interpreting the constitution and especially its attached Charter of Fundamental Rights in such a way as to enforce and accelerate integration. Or it may not have been. No one can be sure.

Aux urnes, citoyens

That lack of subsidiarity, of control, above all of any real sense of constitutional stability are the fundamental flaws of this treaty. The European Union does need a smoother, more efficient decision-making process, both for its own sake and so that it can enlarge itself even more in future, bringing in more countries in eastern Europe and the Balkans, and Turkey. But if voters are to feel comfortable both with that efficiency and that enlargement, they need a constitution that stabilises and controls the process properly. Such a constitution plainly cannot be achieved just by inter-governmental negotiations. It needs to be demanded by voters. That is why the best result in all the ten referendums would be a resounding no vote.

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Retirement

The desk or the dahlias

Jun 24th 2004
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Britain should follow America and abolish the mandatory retirement age

Alamy

THE British treasure the idea of pottering off into the sunset at the end of a respectable career to tend the dahlias, so news of a row within government over raising the retirement age to 70 or abolishing it altogether has spread alarm. But fears that the government is going to hold workers' noses to the grindstone are unwarranted. The current argument is not about the age when people can start their state pensions, nor about whether older people should be forced to work, but about whether employers should be allowed to boot them out for being old.

It is the European Commission's enthusiasm for workers' rights that has brought on this row. In 2000, it passed a directive banning age discrimination. Countries were given six years to conform to the law. The British government promised companies it would pass legislation two years before the directive came into force, so that they would know where they stood. The argument (see article) raging between the Department for Work and Pensions (DWP) and the Department of Trade and Industry (DTI) means the government is likely to miss that deadline.

The argument is over whether or not there should be a standard retirement age in employment contracts. Employers (and the DTI, their voice in government) would like to keep one. Employers want it to stay at 65; the DTI would raise it to 70. The DWP (on the side of the workers) wants to get rid of mandatory retirement ages altogether.

The DWP points out that a standard retirement age makes less sense, these days, than it did when occupational pensions were determined by workers' final salaries. Now that pensions are increasingly determined by the size of workers' contributions, the need for a cut-off point evaporates; and getting rid of it altogether, the DWP argues, will lead people to go on working for longer. The evidence from America, where age discrimination was banned in 1967 and the mandatory retirement age was abolished in 1986, supports that idea.

The final cut

British employers do not want to go down the American road. They say it will make it harder to get rid of unproductive older people because if they try to, they will end up being challenged before an industrial tribunal. Their critics counter that, although American employers do face anti-discrimination suits, there's no evidence that such litigation is a big burden. Anyway, the critics say, culling by age is lazy management: if people get less productive as they get older, employers should monitor and try to improve their performance instead of leaving them to fester until they can be booted out at retirement age. Underperforming employees can (eventually) be got rid of through the normal channels.

The DWP is right about that. But there is a good reason why employers like having an easy way of ejecting older people. By and large, although people get less useful as they age beyond their 40s (see article), they get more expensive. That's the way salary structures have generally worked; and that's the way people expect them to go on working.

They won't. If the DWP gets its way—and it should—the standard retirement age will go and employers will find it harder to get rid of older people. If that happens, older people are likely to find their pay

falling. And if they can't accept that, well, there are always the dahlias.

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The future of NATO

A time to rebuild

Jun 24th 2004
From The Economist print edition

Its mission has changed. But the transatlantic military alliance is worth saving

IF ONLY D-Day commemorations came around more often: that is what the leaders of Europe and America may be murmuring as they head off to a NATO summit in Istanbul next week. Since its last summit, in Prague two years ago, the Atlantic alliance has displayed little of the solidarity recently celebrated on Normandy's sands. NATO has assumed peacekeeping duties in Afghanistan, but failed to find enough troops. It has formed a NATO Response Force (NRF), a pool of elite, mostly European soldiers—but for what eventuality, no one seems sure. It has accepted seven new members—but most of their troops are of little use to the alliance. So there is much to discuss. But rancour over Iraq, darkening the summit like a cloud, may prevent it from agreeing anything useful.

That would be a pity. Despite many claims to the contrary, NATO has yet to define its place in a post-Soviet world. Over the past decade, it has assumed some new roles: peacekeeping in the Balkans and Afghanistan, partnership with Russia, endless diplomatic dialogue. The old concern of defending its members' territory has faded into the background—leaving a question mark as to why the alliance need exist at all.

At first look, America's recent wars seem to have pushed the alliance further off stage. Spurning NATO's offers, the Pentagon shouldered the hardest part of the Afghan war alone. Ahead of the Iraq war, the alliance was at first unable, thanks to France, to play even a bit part, by providing air-defences to Turkey. But somewhere in these messy debates, the principle was accepted that NATO members could hardly shore up their own security without sending troops far afield.

That much was positive. So too is the broad acceptance on both sides of the Atlantic that even in a post-communist world neither America nor Europe is ever likely to face a security threat that does not imperil the other in some degree. But agreeing in theory that America and Europe still need to help each other is only part of the battle: the harder part is making sure that they are physically capable of doing so.

Lost an enemy, not yet found a role

If America has seemed reluctant to fight its recent wars through NATO, that is unsurprising. European forces are so inferior to its own that they are sometimes a burden, useful only for peacekeeping after the shooting stops. But America has not yet reconciled itself to casting its allies in such a modest role. At the last NATO summit, George Bush challenged the Europeans to turn the new response force into a tough, high-tech force. His message was that if Europe got serious about boosting its defences, America would get serious about helping.

That challenge is still on the table. Recently, some European armies have seen quite a lot of action, in the Balkans, Afghanistan and Iraq. In the process, they have improved, with the Italians, for example, commended for counter-insurgency work in Iraq. More typically, though, the Europeans' efforts have justified America's reluctance to use NATO. After ten months of peacekeeping in Afghanistan, the alliance has still deployed only 250 soldiers outside Kabul. A lack of decent troops and aircraft is only part of the problem: more serious is the lack of will among European governments.

For want of better news, NATO's new secretary-general, Jaap de Hoop Scheffer, will make bold claims in

Istanbul for his Afghan mission. In the run-up to the summit, he has begged a few hundred more troops from Spain and a few helicopters from Turkey, allowing a minimal expansion outside Kabul. He may announce that the NRF will be deployed to Afghanistan in September to help secure its elections.

But this will not change NATO's underlying malaise. If the Europeans want to save NATO, they must spend more money on defence and transform their bloated armies into smaller fighting forces, easily inter-operable with America's. NATO's mission in Afghanistan needs urgent expansion.

Nor should this exclude doing more in Iraq, where NATO'S current role consists of giving limited help to Poland's contingent. Once Iraq has its own government, after June 30th, this aid could be increased. The alliance might, for example, provide communications and planning for the 16 NATO members that already keep troops in Iraq individually. France is resisting this, on grounds that NATO involvement in that country would bless an American-led war which defied international law. But that was yesterday's quarrel; the whole Security Council has now blessed Iraq's new government. If the allies cannot stand together in Iraq and Afghanistan, where all see elements of a common threat, what indeed is NATO for?

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Canada's general election

How to squander an inheritance

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Paul Martin lost the campaign, even if he wins the election

Getty

SIX months ago, when he took over from Jean Chrétien as prime minister and leader of Canada's Liberal Party, Paul Martin seemed to be stepping into an enviable inheritance. Under the Liberals' stewardship since 1993, Canada's economy was transformed from a debt- and deficit-ridden disaster to one of the best performers in the rich world. Mr Chrétien had seemingly buried, if not quite killed, the threat of secession by French-speaking Quebec. The Liberal embrace of immigration, cultural diversity and bold reforms such as gay marriage seemed to speak of a tolerant and self-confident country. This newspaper was much impressed by Canada's mix of tough-minded economic management and social liberalism. Last year we ventured to suggest that Canada might be “rather cool”. So thought many Canadians: in December, polls gave the Liberals almost 50% against a fragmented opposition.

Predictably enough, our cautious endorsement seems to have been a kiss of death for Liberal Canada. To the surprise and anger of many Canadians, Mr Martin has been a crashing disappointment in the top job. As finance minister for ten years under Mr Chrétien, he was the co-architect of the Canadian miracle. But the two men were personal rivals. On taking over, Mr Martin enjoyed an impregnable majority in a parliament only three years old. Instead of relying on this, he was obsessed with winning an early mandate of his own.

A big mistake: the voters now look unlikely to give him a mandate worth having. The probable outcome of the general election due on June 28th seems to be a weak and maybe short-lived minority government (see article). This may be formed by the opposition Conservatives, or Mr Martin may scrape back. Either way, such a government would depend on the fickle and perhaps expensive support of the leftish New Democrats and/or the Bloc Québécois, a party whose ultimate purpose is to secure the separation of the French-speaking province from the rest of Canada. In a year or so, Canadians could find themselves at the polls again.

So why are the voters so unimpressed with Mr Martin and the Liberals? Mainly because of a widespread sense that after 11 years they have been in power too long. That was crystallised by a corruption scandal in Quebec, which will cost many votes there. But the Liberals are also wounded by the power struggle between Mr Chrétien and Mr Martin. Instead of running on his record as finance minister, Mr Martin chose to pretend that he was heading a wholly new government.

Chrétien did it better

The trouble is, his brief tenure as prime minister has been singularly ineffective. His advisers have been good at only one thing: knifing their fellow-Liberal rivals in the back—and even then Mr Chrétien did it better. As Toronto's *Globe and Mail* puts it: “The only difference between [Mr Martin's] political manipulations and those of his ‘friendly dictator' predecessor was that the latter didn't leave bloodied fingerprints at the crime scene.” Otherwise, Mr Martin has been a bumbling and hesitant chief executive, trying to placate all voters. During the campaign, he has often seemed tired.

Stephen Harper, the Conservative leader, can also take some of the credit for Mr Martin's difficulties. Despite his inexperience, he showed skill in piloting a recent merger of two rival right-of-centre parties,

the Canadian Alliance and the Progressive Conservatives. His new party is still something less than the sum of its parts. Rather than a merger of equals, it still looks to some Canadians like a takeover of the moderate Progressive Conservatives by the western-based Alliance.

Mr Harper has done his best to rebut charges that he has a “hidden agenda” of social conservatism and would assail Canada's Charter of Rights and Freedoms. But on this, his best has not been quite enough. His contradictory promises of big tax cuts and big spending increases suggest that he did not expect to win. Still, he has made the Conservatives almost electable, something unthinkable less than a year ago. He emerges from this campaign with more credit than Mr Martin.

Though Canada will not fall apart under a minority government, it might not progress much either, and the public finances could be weakened. If the Liberals do squeak back it will be by default, as Canada's only national party. That should be a warning. If he does win, Mr Martin needs to forget about his differences with Mr Chrétien, and focus on the needs of Canadians: more efficient Medicare, a serious defence policy and fixing provincial finance. Otherwise, a Liberal defeat may only have been postponed.

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SpaceShipOne

Up, up and away

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Private enterprise has launched a man into space—inspiringly cheaply

AFP

IT WAS dubbed the “Woodstock of space”, but in the end only one man got high. That man was Mike Melvill, a regular pilot who has just made the transition to being an astronaut by flying 100km (62 miles) above the surface of the Earth in *SpaceShipOne*, and experiencing a few minutes of weightlessness. Twenty thousand people turned up to watch.

Until that flight, only the governments of America, Russia and, quite recently, China were able to put people into space—and then only at vast expense. In particular, NASA, America's space agency, has become renowned for the astronomical sums it is able to spend on projects that fail to achieve their billing. *SpaceShipOne*, however, is a private effort that has cost a mere $20m. For that, NASA could barely launch a kite, let alone an astronaut.

Privatise it

The flight is obviously an historic one. But its significance is deeper and wider than that of being a mere historical milestone. Burt Rutan, the brains behind *SpaceShipOne*, and Paul Allen, its moneybags, are not alone. A growing number of entrepreneurs and their sponsors are attempting to open up the final frontier, taking private enterprise and competition into space (see article). In most other fields of technology great strides have been made in reducing cost and increasing capacity over the years. But while computing costs, for example, have fallen by a factor of 10,000 or more, the cost per kilogram of launching a payload into space has remained virtually immobile.

That is because there have been few truly new entrants to the market. Worse, to the extent that private firms have had a look-in, most of the work in America has been granted to just two giant aerospace companies, Boeing and Lockheed Martin. These have grown fat on cost-plus contracts that have given them little incentive to innovate. It has been difficult to break the so-called “iron triangle” of a government agency and a set of big-corporation and congressional interests at state level. It has taken a few very rich men with a vision of opening up space more widely to challenge the status quo.

Space, of course, is about more than expensive joyrides. Satellites support phones, pagers, television broadcasts, Earth observation and the global positioning system. Weather forecasts are made on their say-so. Droughts and floods are predicted. Crop failures are estimated. And, more romantically, robotic probes travel throughout the solar system, orbiting and landing on other planets.

Many forecasters, though, think that most of the near-term growth in space launches will come from another source: space tourism. Several studies confirm that there is interest in, and a likely market for, such tourism, even assuming (albeit speculatively) costs of $100,000 per person per flight. But while the excitement is justified, it is probably a tad early to get the spacesuit fitted. *SpaceShipOne* will not be taking tourists anywhere just yet. Its next step is to try to win a prize for a vehicle capable of taking three people into space twice within two weeks. But the design that is best to win that prize is not necessarily the best design to operate as a commercial vehicle for space tourism, where having low recurring costs is more vital.

In this context government does have a role—getting out of the way. For if civilian spacecraft are regulated as if they were aircraft, which is a serious risk in America, then the costs of compliance could

be in the hundreds of millions of dollars. This would finish the industry off before it got started. And why should the red tape and lessons of a hundred-year-old industry be used to regulate one that has barely begun? In the early days of commercial spaceflight, the risks will most definitely be high, as they were in the early days of aviation. The inevitable accidents will have to be accepted by those who participate. That includes passengers, who can surely be required to acknowledge the risks they are taking.

Two lessons of history are pertinent: greater rewards require greater risks; and new frontiers are not amenable to monopolistic control by government. The chance to be among the first 1,000 people to leave planet Earth will convince many. Let the spaceships fly.

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Letters

Jun 24th 2004
From The Economist print edition

The Economist, 25 St James's Street, London SW1A 1HG
FAX: 020 7839 2968 E-MAIL: letters@economist.com

Who beat communism?

SIR – While Ronald Reagan was indeed morally opposed to mutually assured destruction, it was Mikhail Gorbachev who developed a plan, in the form of arms reduction and minimum deterrence, to break out of the cycle ("The man who beat communism", June 12th). America's arms build-up began under Jimmy Carter in the late 1970s, although Mr Reagan accelerated the process.

It was only when Mr Gorbachev became secretary-general of the Soviet Communist Party in 1985 that tensions began to subside and progress was made. His proposals were based on a firm belief that fewer nuclear weapons afforded greater security, rather than the other way around. More than anything, it was this "new political thinking" that changed the face of international relations forever.

Nicole Evans
Oxford

SIR – Mr Reagan was in the right place at the right time, as much constrained by the political situation as master of it. By 1978 the countries of the Soviet block had substantial debts and serious economic difficulties, which were then exacerbated by the Soviet invasion of Afghanistan. After Afghanistan, the Soviets modernised their nuclear arsenal and threatened to move nuclear weapons into central Europe, forcing Mr Reagan to respond to their bluff. His master stroke was the "Star Wars" initiative. Although the required technology did not exist, the Soviets took fright. They devoted ever more to military spending, undermining their fragile economy and finally causing its collapse. The rest, as they say, is history.

Andrew Ryder
Portsmouth

SIR – You claim that Mr Reagan was "the man who beat communism". Yet the People's Republic of China remains with us even though Beijing's power elite ignores ideology in its economic plans and simply retains the apparatus of the communist police state. At the same time, this disproves the liberal-left argument that communism was inherently unstable and bound to fall with or without Mr Reagan in the White House. He could only focus political and military pressure on the Soviet block. As you say, he was "blurry about China".

Anthony Martin
London

SIR – We may well agree that Mr Reagan beat communism. But he was playing a game of chicken with our lives. Mr Gorbachev wisely pulled to the side of the road. It is to him we owe our gratitude, not the reckless driver.

Lawrence Sinclair
New York

SIR – You say that conventional wisdom in 1980 held that Mr Reagan lacked the intellectual prowess for the job of president. However, it is apparent that Mr Reagan possessed intellectual powers and new ideas for areas of lifelong interest to him. This happened to coincide with topics that were of vital importance to

the world then: democracy, free markets, and growth-oriented fiscal and economic policies for America and other capitalist societies. His governance had notable successes and failures, but his approach of using simple paradigms and ideas to solve complex social and economic problems is a valid form of applied intellectualism.

Bryan Calkins
San Francisco

SIR – Mr Reagan's legacy includes mass graves in Central America that are still being excavated, graves filled with victims of crimes for which no one has ever been convicted and an entire region is left mired in desperate poverty and injustice.

Joan Ponsford
El Paso, Texas

SIR – The most credit for developing a strategy to defeat communism should be given to Harry Truman. He developed the doctrine followed by every administration up to that of Mr Reagan. He stopped the spread of communism through the Marshall Plan, coming to the aid of Greece, protecting our position in Berlin with the airlift and coming to the aid of South Korea when the North invaded. Mr Reagan's decisions pale in comparison.

Saul Nova
Denver

SIR – You dishonour the hundreds of thousands of men and women from many countries, who over decades gave of their intellects, energies and lives to bring down the “evil empire” to the point where a tweak from Mr Reagan could bring it down like a rotten fruit.

Herman Archer
Heiligenstadt, Germany

The better of two evils

SIR – You raise an interesting question by asking “Which is worse, state ownership or corrupt privatisation?” (“Steel crazy”, May 29th). I suspect that the citizens of Ukraine (and other post-communist countries) are, on balance, more likely to benefit from a corrupt system where personal gain encourages state divestment rather than a less corrupt one where management remains fossilised in state ownership.

David Scott
Loughborough, Leicestershire

Crime and punishment

SIR – You say that fraudsters get sentences mainly reserved for “murderers, rapists and armed robbers” but do not mention the punishment of drug conspirators and petty dealers (“Bosses behind bars”, June 12th). Possessing 5-10 grams of crack often earns a sentence of ten years to life. I am currently sitting in a federal correctional facility for a second marijuana offence. People like me face the same sentence. There is a lack of nuance, deliberation, and careful consideration by legislators when passing sentencing guidelines. Excessive sentences for fraud should be checked, but only if the whole system is revamped. Don't forget the little guys who respect the laws of supply and demand and the free market that you proselytise.

James Della Bella
3144198
Monmouth County Correctional Institution
Freehold, New Jersey

Wild about Harry

SIR – You are right that there is nothing new bursting on to cinema screens today (“Harry Potter and the familiar formulae”, May 29th). But “Harry Potter and the Prisoner of Azkaban” is not part of the

phenomenon. First, seven Harry Potter books are planned, so you could not expect that only one of them would be made into a movie. Second, the director has changed (for the better) and made a great film. Third, the film has nothing to do with its predecessors, apart from the actors and music. The clothes, light, colours and castle have all changed. This film is genuinely new and, despite the caption, your picture of Harry, Ron and Hermione in front of Hogwarts has not been seen before.

Fanny Durand
Nantes, France

The wrong side of the road

SIR – You show George Bush riding in a sidecar on the left-hand side of the governor of California (Lexington, June 12th). Is it the much-vaunted “special relationship” that has enabled Tony Blair to persuade Mr Bush that America should adopt the British rule of the road?

Maurice Devèze
Red Hill, Australia

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The Iraq handover

Barely ready, not yet steady

Jun 24th 2004 | BAGHDAD
From The Economist print edition

Getty

America's remission of power in Iraq is, of necessity, much subtler than it seems

Get article background

JUNE 30th has long been seen as a date of almost mystical significance for the future of Iraq. On that day, America will hand over to an interim government of Iraqis, and Paul Bremer, the American proconsul, will leave the country. Yet behind the symbolic toings and froings, how much will really change? And how much power will the Iraqis really have?

Iyad Allawi, a Baathist leader in Europe who plotted against Saddam Hussein in the 1990s, is the prime minister-designate. He is seen as tough; “our kind of bully”, as a State Department hand describes him. Under the temporary constitution, the Transitional Administrative Law (TAL), cabinet decisions are law, and decrees already in force, such as those that laid down a new press law or set up the independent regulator of state media and mobile phones, can be scrapped by cabinet order.

Mr Allawi's “caretaker” powers are supposed to expire after elections for a National Assembly in January 2005. Some wonder whether they will, especially if security fails to improve. On the eve of the handover the fighting intensified, with black-clad insurgents battling the police in two towns west and north of Baghdad.

Most Iraqis, however, seem relieved to have one of their own back in charge. According to a poll conducted by Baghdad's Centre for Research and Strategic Studies, only 2% of them consider the Americans liberators. And the sickening spate of car-bombings and assassinations has left them craving the return of a strongman. Baghdad's city council has called for martial law to be declared in the capital for six months. Many are demanding a curfew.

Mr Allawi's team want to be seen to be up to the job; this is not, they believe, a time for soft talk. The justice minister has called for the revival of the death penalty, the defence minister has promised personally to cut off rebels' hands and heads, and the interior minister has ordered his police into no-go areas such as Baghdad's weapons market. More daring policemen are issuing fines for driving offences for the first time since the war. Mr Allawi has also promised to reintegrate senior Baathists excised by Mr Bremer, and has announced the remobilisation of five of Iraq's disbanded army divisions to support the police. “Disbanding the Iraqi army was a big mistake,” he says. “We are fixing the mistakes of the Americans, aren't we?”

Baathists are understandably elated. Some are drawing historical parallels with the 1960s, when Baathists were overthrown in 1963 only to regain power in a coup five years later. “We're organising for the next,” says a former scribe of Mr Hussein's. Although the rebels' strike-rate remains high, with 45 attacks a day, it is growing less lethal for American soldiers (see chart). The car-bombings and decapitations, optimists suppose, may be a sign of weakness, not strength.

The prospect that the old regime may rear its head has given some Americans pause for thought. Officials of the outgoing coalition authority resist the idea that Iraqis, rather than multinational forces, should impose martial law. The latest UN Security Council resolution on Iraq, they insist, gives the American-led multinational force authority to use “all necessary measures”. Iraq's armed forces, it is understood, will be subject to the coalition's operational command, though the Iraqi government will take strategic decisions.

Comparisons with the brutality of the former regime are certainly premature. While Mr Hussein had 70 divisions, Mr Allawi will have a single armed division of 8,000 soldiers. In addition, he can call on a newly named National Guard, comprising 40,000 ill-trained local men. He will have no heavy weapons, and just 16 helicopters for transport and reconnaissance. His embryonic defence ministry, which still has no phone system, has unveiled a plan to send Iraq's army from house to house in the troubled Sunni towns west of Baghdad and the Shia towns south of it. But against an opposition heavily armed with mortars and rockets, government forces on their own will be out-gunned.

Mr Allawi will also have much to do elsewhere. The main arterial roads from Syria and Jordan through the desert to the capital fall in an area outside Baghdad's control, and the nine-kilometre stretch from Baghdad to its airport, known as Ambush Alley, remains Iraq's most dangerous road. American forces have handed two towns, Fallujah and Baquba, to their opponents after inconclusive battles.

Other forces are also seeking to carve out their zones. Hotheads in the Shammar tribe are threatening to go on the rampage. The Kurds, entrenched in the north, have been pushing ever deeper into the oil-rich town of Kirkuk to the south. The limits of central authority were revealed when, the day after ordering that all Iraq's militias be disbanded, Mr Allawi backtracked and said that the two Kurdish regional governments could keep their *peshmerga* militias.

Even in the capital, central authority has a small remit. Despite Mr Allawi's ban on militias, paramilitaries loyal to the Supreme Council for Islamic Revolution in Iraq (SCIRI), an Iranian-backed Shia group, took to the streets recently to protest against the burning to death of six drivers by Sunni extremists. Across the country the authorities claim that 500 courts are functioning, but even in the most elegant parts of Baghdad they have to compete with the roadside awnings of all-male *sharia* and tribal courts, known as *fasls*. Secularisation looks good on paper, but not on the streets. Under American pressure, women won 25% of ministries in the interim government and the Governing Council's Law 137, which imposed *sharia* law for personal affairs, was reversed. But honour crimes are again on the rise.

Towards elections

Mr Allawi can call on American forces for help, but will not want to look like a lackey. Unlike Mr Hussein, he will have to rely on co-option, not repression, to draw together Iraq's centrifugal forces. The effort has already begun. Under the banner of national reconciliation, a committee is preparing a list of 1,000 names to join a conference at the end of July, from whom will be drawn a 250-member National Council to monitor the government and—if it secures a two-thirds majority—veto cabinet orders. But enthusiasm has ebbed. Key groups—including the Muslim Scholars' Council, a body of anti-American Sunni clerics—have already announced a boycott. Fearing further rejection, the council has revoked its invitation to the most turbulent Shia cleric, Muqtada al-Sadr.

In the months before the January elections, prospective candidates (and the Allawi government, too) are keen to show themselves untainted by collaboration with the occupation. Some peculiar alignments are beginning to appear. Ahmed Chalabi, the

fallen angel of the Pentagon's neo-cons, has put out feelers to run on a “Shia House” ticket with Mr Sadr, who holds sway over Baghdad's crowded Shia slums. Massoud Barzani, a Kurdish leader, is seeking out Sunni Arab allies among the large Jabour tribe. And merchants are rediscovering their tribal roots.

If all goes to plan, a new government will take office after the general election in January and will see a permanent constitution through the National Assembly to serve as the basis of general elections by the end of 2005. But it is by no means certain that the timetable will be kept to. In mid-June Kofi Annan, its secretary-general, announced that he was delaying the UN's return to Iraq until it was safer.

And what if Iraqis vote the “wrong” way, in America's view? Mr Bremer may have been loth to hold early local or national elections for fear that Islamists might win. The new interior minister is already muttering about the dangers of “democratic militants”.

Confident they can cope

Which of the following contributes most to your sense of security?, %

Neighbours and friends	45
Family	26
Local police	18
Local neighbourhood patrols	4
None or other	3
Mosque patrols	2
Joint coalition forces and Iraqi patrols	1
Coalition forces	1

Do you think it is likely that the Iraqi police and army will maintain security without the presence of coalition forces?, %

Very likely	62
Somewhat likely	25
Not very likely	6
Don't know	4
Not at all likely	3

When should coalition forces leave Iraq?, %

After a permanent government is elected	45
Immediately	41

Source: Coalition Provisional Authority, May 2004

Allawi's underpinnings

All this said, Mr Allawi has two assets that his rivals do not. His government controls the oil revenues, and is underwritten by a superpower. Despite the Americans' promises of a market economy, they are handing over a socialist centralised state with oil revenues delivered as subsidies, nationwide food rations and burgeoning public-sector salaries. Even workers at the industry ministry's 80 factories, idle because there is no electricity to power them, get their bonuses as usual.

Reuters

All in good time

Most crucially, Mr Allawi is underpinned by a 150,000-strong multinational force, of whom all but around 17,000 are American. The award of a $293m contract to a British soldier of fortune, Tim Spicer, has also brought thousands of western and Asian mercenaries under America's wing and beyond the reach of Iraqi law.

The Americans say they are handing over a judiciary that is independent of the justice ministry. The innocuous-sounding Central Criminal Court, staffed by American-picked judges to try “fast-track” cases, is to return to the judicial fold after the handover. Already two members of the Governing Council have been summoned before the court. Many lawyers fear that after June 30th standards will slip again.

Saddam Hussein will be among the first of some 6,000 detainees to be transferred to Iraqi jurisdiction after the handover, say American officials, as soon as the sovereign government issues arrest warrants. But to ensure he does not escape, he is expected to stay physically in American custody while being

legally in Iraq's, and the Americans now say they will sign an agreement to this effect with the Iraqi government. Some 1,300 detainees are due to be released by July 1st. But the other 4,000-5,000 will stay in American custody until the Iraqi authorities can guarantee due process and a secure court.

Mr Allawi has appealed to Arab and Muslim states to supply weapons in an attempt to circumvent American curbs on rearmament, and has proposed revamping the old regime's weapons (including a mothballed squadron of MIGs). But his armed forces remain dependent on American finance. In the 2004 budget, all but $300m of the $1.5 billion for military spending is provided by the United States. Western advisers at the defence ministry believe that, if the interim government seeks to accelerate the Americans' timetable for growth (three divisions by the end of the year), funds could be withheld.

The same strings apply to Mr Allawi's other ministries, which also depend on American aid for much of their capital budgets. Although all the ministries are now headed and staffed by Iraqis, some 150 mainly American advisers will continue to work from the same desks inside the Republican Palace as before the handover. (The British will “lead” in the finance and defence ministries, the Australians in the agriculture ministry.)

The UN resolution also binds Iraq to uphold deals already financed by the Americans from the country's oil revenues deposited in the Development Fund for Iraq (DFI). Over the course of the occupation, the Americans have already spent $11.3 billion of the $20.2 billion DFI revenues and have committed a further $4.6 billion, much of it in recent weeks. Hundreds of millions of dollars were used to hire western military companies to secure strategic sites, such as the national broadcasting centre, and keep them, for the time being, out of Iraqi control. British security firms have won contracts that give them control of access to both Baghdad International Airport and the port at Um Qasr.

America's armed forces rightly claim they have gone out of their way to relocate their largest camp in Iraq—housing 15,000 soldiers—in order to hand back Baghdad airport to Iraq's transport ministry. But the western companies, citing legal liability, say they will determine which Iraqis can go there. For now, the Americans will also continue to control access for airlines.

Many Iraqis feel that America is handing over not to them but to western contractors, who will be granted immunity from Iraqi law. And while jobs are parcelled out to such contractors, 2m out of Iraq's workforce of 7m remain jobless, fuelling the anger which feeds the insurgency. As of April, the Americans had created about 395,000 jobs; the Bush administration had promised 850,000.

Broken, but hopeful

The past year's financial blackout has set a poor standard for Iraq's new government to follow. Iraq's oil revenues will be overseen by the UN's international auditing and monitoring body, which can be expected to acquire greater muscle. Mr Bremer has also ordered an internal auditing system for Iraqis, with a commission for public integrity and inspector-generals appointed to each ministry. And he has appointed independent regulators to keep the politicians from meddling. These well-intentioned ideas may not result in virtue, all the same. Ministers appointed to their posts for seven months will have scant time to master their portfolios, and may opt to feather their beds while they can.

The changeover at the ministries has compounded Iraq's dislocation. The rudiments of a bureaucracy are in place, but the wrecks of Mr Hussein's vast government buildings still loom over the city. The stock exchange, meant to open in January, has yet to begin operations.

Much can be blamed on the rebels. Iraqis had been promised they would have 6,000MW of electricity by the start of the summer. Instead, thanks to attacks on General Electric and its Russian partners, they have just over 4,000MW. Attacks on pipelines in the northern and southern oilfields have reduced exports sharply (costing Iraq $1 billion, Mr Allawi says) and have cut supplies to power stations.

At times, it seems that America's own faith is wavering. The 3,000 staff billed to fill its embassy have been reduced to 1,000. And hardly any of the $18.4 billion in congressional money for Iraq's 2004 capital budget has arrived. Although administrators have earmarked $10 billion for projects, they have awarded only $3.2 billion, most of which will go for building military bases. Sub-contractors complain that the coalition's largest contractor, KBR, is months behind on payments.

Other aid donors—who pledged some $13 billion last November—have also held back for political as well as security reasons. This week, Iraq's president, Ghazi al-Yawar, complained that only 10% of Iraq's aid

had arrived. France and Germany, for their part, are insisting on at least some debt repayments before they will return to operate in Iraq's post-war economy.

Meanwhile, ordinary Iraqis get their comfort where they can find it. In search of anything from a cure for their sick infants to marriage guidance, some of Baghdad's poor head up a squalid cul-de-sac to the door of a Sufi master's *takiya*, or house of worship. The master, Said Rifayi, offers them his spittle and his blessings, interspersed with curses which echo the insurgents' graffiti daubed on the walls. Once he advocated a personal *jihad* to correct the erring soul; now he preaches *jihad* to defend Islam, no matter how slim the odds.

After the prisoner-abuse scandal of Abu Ghraib, it is harder to portray America's presence to Iraqis as a force for good. In the summer heat, American soldiers have grown increasingly irritable. Hundreds of Iraqis are still hungry to avenge dead relatives and unfair detentions. Asked by diplomats whether in three years' time the fighting would be over, a senior American official expressed doubts.

Yet even America's greatest critics in Iraq feel some good has come out of the war. Where there was one megalomaniac in power, there is now a myriad of power-brokers. Eighteen television stations are about to take to the air in Baghdad alone, and Iraqis can try (though they often fail) to talk by mobile phone. A newspaper editor threatens to throw tomatoes at Mr Allawi's government if he fails to deliver, and fears no retribution. And nearly half of all Iraqis, according to the survey cited above, say they want America's forces to stay until after the January elections.

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Clarification: Renaissance Services

Jun 24th 2004

In our edition of May 13th, we wrote that Renaissance Services, a catering company that feeds the American army in Baghdad, had "justified its refusal to talk about a strike after claims of abuses because it was under contract not to talk to the press". We would like to make it clear that the strike referred only to a dispute, later resolved, over hours of work and rest periods, and that Renaissance should in no way be tarred with the brush of abuses referred to elsewhere in the article.

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The economy

Playing it cool

Jun 24th 2004 | WASHINGTON, DC
From The Economist print edition

Getty

Is Alan Greenspan fretting enough about inflation?

Get article background

ON JUNE 30th America's central bank looks set to raise short-term interest rates for the first time in four years, probably by a quarter percentage point to 1.25%. The move has been so well flagged by Alan Greenspan and his colleagues that it will surprise no one. Nonetheless, it is a significant turning point. After cushioning the economy from serious recession by slashing rates to 1%, Mr Greenspan now faces an equally tricky task: to tighten today's extraordinarily loose monetary policy without derailing the economy.

So far, the Fed's strategy seems to be gradualism. At their last meeting in May, the central bankers talked of tightening policy at a pace “that is likely to be measured”. Though Mr Greenspan and others have made it clear since then that they will do what it takes to contain inflation, no one seems in any great hurry. Indeed, Mr Greenspan sounded positively languid last week, telling senators that “inflationary pressures are not likely to be a serious concern in the period ahead”.

That is why financial markets expect only a quarter-point rise in rates on June 30th. Attention instead will be focused on what exactly the central bankers say in the accompanying statement, particularly whether they reaffirm their commitment to a “measured pace” of tightening, or add some tougher phrases.

Does the economy justify such a laid-back approach to raising interest rates? The answer depends a lot on where you look.

Inflation-worriers, including *The Economist*, have pointed out that the economy is growing apace, inflation is rising and yet short-term interest rates, even after June 30th, will be negative in real terms. In the year to March output grew at its fastest pace for 20 years. Consumer prices rose by 3.1% in the year to May, up from 2.1% a year ago. Admittedly, much of that rise is due to higher oil prices, but even core consumer prices—which exclude the volatile categories of food and fuel—are edging up, from 1.1% in the year to January to 1.7% in the year to May. And people think inflation is on the rise. According to a survey by the University of Michigan, Americans' expectation of inflation over the coming year is now 3.3%, up from 2% last May.

More optimistic analysts note that inflation is still extremely low by historical standards. They point out that much of the recent acceleration may be due to temporary factors; and argue that price pressure is unlikely to damage an economy which still has a lot of excess capacity and where productivity is growing strongly.

According to conventional benchmarks, America's economy still has plenty of slack. The jobless rate at 5.6% is well above levels consistent with stable inflation and traditional measures of industrial capacity use are below historical averages. There are also signs that the jump in inflation at the beginning of the year is already abating: May's monthly core consumer prices rose by 0.2%, compared with 0.4% in March and 0.3% in April.

The Washington-based governors of the central bank fit broadly into this sanguine camp. Some of them place considerable weight on the slack that remains in the economy. Donald Kohn, a Fed veteran and perhaps the governor who is closest to Mr Greenspan, made clear in a speech earlier this month that much of the inflation acceleration in early 2004 was a rebound from “unexplainably low inflation last year” as well as the one-off effect of higher prices for energy and other commodities as well as a weaker dollar. Though the analysis was filled with caveats about how little is known about the inflationary process, it endorsed a gradualist strategy.

By contrast, the presidents of the regional Federal Reserve banks are traditionally a more hawkish bunch, less trusting of “output-gap” based analyses of inflation. But their influence is also much smaller.

Easily the most important factor, however, is what Mr Greenspan himself thinks. Formally sworn in to a fifth term as Fed chairman on June 19th, Mr Greenspan dominates the discussion of monetary policy. Though famously sceptical of any single model of the economy, he has led the gradualist argument. But recently he has sounded both concerned and sanguine in quick succession.

In a speech on June 8th, he pointedly noted that the central bank would do “what is required” to maintain price stability. Financial markets interpreted a hawkish signal and quickly anticipated sharply rising interest rates. A week later, in his comments to senators, Mr Greenspan adopted a more relaxed tone, and financial markets readjusted their expectations to a quarter-point rise on June 30th. The truth is that Mr Greenspan probably believes the central bank can act gradually, but wants to keep the option of ratcheting up rates if necessary.

Appealing as it sounds, this kind of wait-and-see approach poses problems. Over the next few months the economic statistics are unlikely to “prove” that either the hawks or doves are right. As Jan Hatzius of Goldman Sachs points out, the one-off effect of higher input prices alone could boost consumer prices for several more months. Given that last year's inflation was so low, arithmetic suggests there will be big year-on-year rises in consumer prices, even if the monthly figures remain well behaved. Yet these figures might help to raise people's expectations of further inflation. The real problem, however, is that by the time you are sure inflation is taking off, it is too late: it takes many months for higher interest rates to dampen inflation.

Given this lag, and given the extraordinarily low level of rates today, the Fed's gradualism is surely a gamble. Last week, Mr Greenspan, an avid golfer, told Congress that while he reckoned the Fed was on track to normalise interest rates while keeping the economy stable, it was not a “gimme” putt (a putt so easy that other players give you the shot). In fact, another metaphor may be more appropriate. In the friendlier sort of golf, if you mess up a shot, your opponent can let you take a “Mulligan” and try again. The American economy is less charitable.

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The Chumash tribe's inheritance

Davy Crockett rides again

Jun 24th 2004 | SANTA BARBARA
From The Economist print edition

Friendly doings with the Indians, unusually

ENOUGH of muskets and tomahawks; today's battles between white settlers and their Indian predecessors are all about property development and casinos. This week, Arnold Schwarzenegger signed a deal with five of California's 107 Indian tribes that allows them to expand their slot-machine operations in exchange for a fat bundle of tax revenues: a first payment of $1 billion will go to transport projects. However, the governor, fetchingly draped in a tribal blanket, announced that he would oppose any new attempts to expand casino gambling in the state.

This vow may yet affect an intriguing battle under way just outside Santa Barbara, involving several former Hollywood types and 153 Indians. Back in 1998, Fess Parker, a 79-year old businessman once best known for playing Davy Crockett and Daniel Boone on television, bought 1,400 acres of the Santa Ynez Valley for $6m. However, officials in Santa Barbara County rejected his proposal for a hotel and golf course on the land, saying it was zoned for agricultural use only.

Last year, Mr Parker tried unsuccessfully to sell the land for $28m. Then, three months ago, he struck a deal with the local Chumash tribe: the Indians, who number just 153 people and already run one casino, agreed to pay $12m for 745 acres, which they would then annex to their reservation for tribal housing and possibly a golf course, a resort hotel and “market-rate housing”. In addition, the tribe and the Fess Parker Ranch agreed to form a joint-venture to run the project.

The word “casino” was not mentioned, but the mere suspicion that this is the plan has driven what a Chumash spokeswoman calls the “RAWGs” (rich, angry, white guys) to protest against it. The locals, who include Bo Derek and Michael Jackson, worry that a casino would increase traffic and crime. Even if there is no casino, they fear a resort development will spoil the landscape. As for Mr Parker, their view is that he is cleverly avoiding zoning regulations by doing a deal with the Chumash.

In a recent full-page advertisement in a local newspaper, Bernie Taupin, who wrote many of Elton John's better lyrics, declared that “Should this atrocity go ahead, it would surely be the beginning of the end for this pastoral wonderland we cherish. The fight has only just begun. I can guarantee we will snap at Mr Parker's lanky heels till his skin is raw.”

What good that will do remains to be seen. America's Indians are sovereign nations, so the Chumash need seek the permission only of the Bureau of Indian Affairs in Washington, DC, and not the Santa Barbara authorities, in order to annex the land to their reservation. Such requests are almost always approved, especially if the development includes tribal housing and an improvement in the tribe's wealth. Once the land became part of the Chumash reservation, it would be exempt from many state and local regulations, including the present zoning restriction.

As the final points of the land purchase are tied up, the head of the tribe, Vincent Armenta, is doing his best to soothe the local RAWGs. The tribe's plans are preliminary, he insists: “We will listen to the community and respond to their concerns.” And he says there will definitely be no casino, as it would spoil business in their current gaming parlour, which is only two miles away.

To the Chumash, far too much of the opposition is motivated by old-fashioned racism. As Frances Snyder, a tribal spokesman, puts it: “The American dream is OK, but they don't like us having it”—despite handsome contributions to the local community from the profits of the tribe's casino. Meanwhile, Mr Parker says simply: “I am honoured to work with the Chumash tribe to create an environment that they will be proud to call their own, because after all, it was theirs to begin with.”

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The torture controversy

Fanning the flames

Jun 24th 2004
From The Economist print edition

The administration opens up a little

THIS week the White House at last tried to come clean over the allegations that it somehow authorised the apparent torture of prisoners in Iraq and elsewhere. On June 22nd, the administration released hundreds of pages from internal memos. Then the Justice Department let it be known that it was rewriting its legal advice on how tough American interrogators can be. Meanwhile, at the United Nations, the administration dropped its attempt to extend a resolution giving American troops immunity from war crimes—something other countries felt was an attempt to undermine the International Criminal Court.

The release of the documents came hard on the heels of two embarrassments. The first was the revelation that Donald Rumsfeld, in one of his more Kafka-esque moments, had in effect designated one particular prisoner in Afghanistan a “non-person”, insisting that his name be removed from all official records. The second much bigger embarrassment had been the leaking of the Justice Department's current torture memo, written in 2002, which seemed to imply that some forms of torture might be legal. Attempts to depict the memo as a purely theoretical exercise by a rogue lawyer were somewhat undermined by the fact that George Bush nominated the author to the Federal bench.

This week's voluntary offering of memos provides evidence for both sides. Legally speaking, the practices outlined in the memos do not amount to torture, as George Bush was quick to point out. They also seem to confirm the administration's case that its guidelines were considerably stricter than those defined in the Justice Department memo.

But they hardly made reassuring reading—and not just because many documents still remain secret. Human-rights people claim that some of the procedures outlined amount to violently coercive interrogation—something that is banned by both the Geneva Conventions and the UN Convention Against Torture. Mr Rumsfeld authorised a list of coercive techniques in late 2002, including giving permission for prisoners to be stripped naked, terrorised with dogs and interrogated for up to 20 hours. He withdrew the order two months later. It is unclear whether similar methods may still be officially sanctioned.

While Mr Bush has been retreating over the issue of immunity at the UN, his officials also made it clear this week that American troops and personnel in Iraq would be safe from prosecution in local courts after the June 30th handover. And critics are increasingly turning their attention from Iraq to Afghanistan, where America has reserved the right not to observe the Geneva Conventions when handling suspected al-Qaeda fighters.

According to a report this week in the *Guardian*, a left-leaning British newspaper, at least five suspects have died in American custody in Afghanistan. At least three of the deaths were ruled homicides but, 18 months later, no one has been prosecuted for them. The newspaper also details further allegations of abuse, including prisoners being beaten, sexually humiliated and forced into excruciating pressure positions. American officials in Afghanistan said an internal investigation into the allegations was going on, and that interrogation procedures have been changed.

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The electoral week

On the trail

Jun 24th 2004
From The Economist print edition

Counting your chickens

“Both candidates in this race are honoured to be the friend of John McCain. Only one of us gets his vote, and I am proud that it is me.”

George Bush in Nevada, June 19th

How to make friends

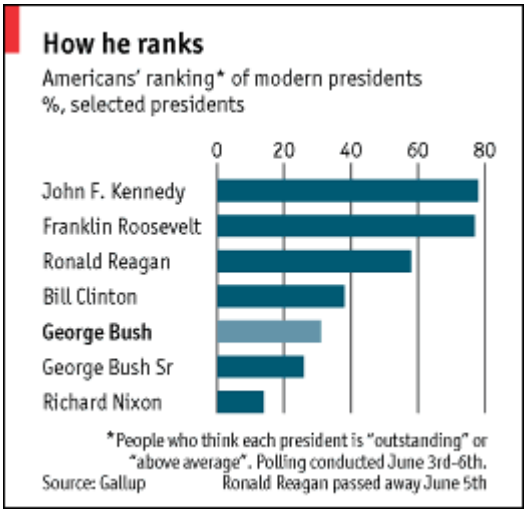
“They're almost all puppets. There are two sets: congressional puppets and White House puppets. When the chief puppeteer comes to Washington, the puppets prance.”

Ralph Nader on the power of the Israeli lobby. American Conservative, June 21st

Gonzo for attorney-general?

“Just to put your minds all at ease, I have four words that I know will relieve you greatly. How does this sound—‘Vice-President Hunter Thompson'?”

John Kerry met the author of “Fear and Loathing in Las Vegas” on a trip to Colorado. Washington Times, June 22nd



Start them early

“Are they cute or what?”

Lynne Cheney to her husband at a sporting-goods store in Missouri. She bought camouflage baby clothing for the vice-president's grandchildren. ABC News.com The Note, June 22nd

Food of the gods

“It comes down to chocolate...Pumpkin-spice cookies—we might as well call the election now! Put a spatula in it, it's done.”

Nancy Lloyd, a former editor at Family Circle, explains why Laura Bush's oatmeal chocolate-chunk recipe will beat Teresa Kerry's pumpkin-spice cookies in the magazine's cookie-recipe contest. Readers have voted correctly in the past three elections. Washington Post, June 22nd

Two is always better than one

“The religious right doesn't understand why we would have the twins in our advertising. But I've had an

equal number of people come up and say, ‘Boy if you took the twins on the campaign trail, we'd really vote for you'.”

Pete Coors, a Republican Senate candidate in Colorado and erstwhile brewing boss, on his cunning use of two scantily clad blondes to sell beer to men. Denver Post, June 22nd

Southern wisdom

“Where I come from, we say a fish stinks from the head down, and that's exactly true in this case.”

John Edwards, campaigning in Texas, on the problems at the Abu Ghraib prison, June 18th

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Connecticut politics

A tale of a hot-tub

Jun 24th 2004 | STAMFORD
From The Economist print edition

What troubles await the ex-governor of Connecticut?

“ARROGANCE, cronyism, incompetence and corruption.” With these choice words, a young Republican politician called John Rowland blasted Connecticut's Democratic state government when he first ran for governor in 1989. Fifteen years on, Connecticut's voters have been hurling the same pejoratives at Mr Rowland himself.

After a string of scandals involving hot-tubs, a renovated Ford Mustang and (what else?) Enron, Mr Rowland was about to become the first governor of Connecticut to be impeached by his legislature. On June 18th the state's Supreme Court ruled that he could be forced to testify before these impeachment hearings. Mr Rowland resigned three days later. “My poor judgment has brought us here,” he said, and few could disagree.

EPA

Rowland bows out

Mr Rowland's troubles came to a head in December, when he first denied, and then admitted, accepting $1,000-worth of free work on his lakeside holiday cottage in Litchfield. His wife, Patricia, fanned the flames by penning a seasonal poem lampooning the local press and suggesting she and her husband were the victims of a smear campaign. Upset by this lack of contrition, Connecticut's hacks began calling for the governor's head.

If that were all, the Rowlands might have had a point: Connecticut's political machinery feeds on solider fare than hot-tubs and new kitchen cabinets. Those gifts, however, came to the public's attention thanks to a federal investigation into allegations of much worse corruption in the state capital, Hartford. These investigations have encompassed Mr Rowland's former deputy chief-of-staff, Lawrence Alibozek, his ex-chief-of-staff, Peter Ellef, and a number of contractors linked to the Tomasso Group, a collection of local construction companies that have recently won more than $100m-worth of state building contracts. The Tomassos, who are family friends of the Rowlands, helped to arrange the work on the Litchfield holiday cottage. Mr Alibozek has pleaded guilty to corruption charges after investigators found a cache of gold coins buried in his garden. Mr Ellef may be charged soon.

Although federal investigators subpoenaed documents from Mr Rowland in January, nothing yet suggests that they plan to move against him. A sympathetic explanation is that the governor practised a style of back-scratching politics which has fallen out of favour with voters only recently. The rotten politics of Bridgeport and Waterbury, two struggling Connecticut cities, have claimed the heads of several mayors in succession in recent years. Mr Rowland, a Waterbury good ol' boy, may have become a symbol of what is suddenly considered to be unacceptable behaviour. The serious graft could conceivably have taken place at lower levels.

On the other hand, poor judgment does seem to be an enduring feature of the governor's political career. Besides the cottage renovation and the chap with the gold coins buried in the garden, there are questions about a condominium sale in Washington, DC, gains from a Connecticut property-investment partnership, a suspect deal between Enron and the state rubbish authority, and that Ford Mustang, which was given to Mr Rowland at a Tomasso family bash.

Meanwhile, the state's former treasurer, Paul Silvester, is serving a four-year jail sentence for taking kickbacks and bribes to steer state pension-fund business, a scandal that has touched the waspish,

manicured suburbs of Connecticut's southern Fairfield County. With their ex-governor stripped of the protection of office, voters will soon find out exactly how venal their government has been.

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Sex and the Illinois Senate race

He said, she said, his party lost

Jun 24th 2004 | CHICAGO
From The Economist print edition

Bad news for Republicans in the mid-west

WHAT would Abraham Lincoln say—let alone strait-laced Mary Lincoln? Abe's heirs in the Illinois Republican Party stagger from one scandal to another, or at least from one Ryan to another. Just when news seemed to have moved on from former Governor George, who was indicted on various fraud charges late last year, the party now has to decide what to do with Senate candidate Jack.

Mr Ryan, an investment banker-turned teacher, had seemed a dream candidate, equipped with wealth, good looks and even a social conscience. Now records from his divorce case have been made public by a California court. In them, his ex-wife, Jeri, an actress best known for her role in “Star Trek”, claims that he took her to sex clubs in New York and Paris and asked her to have sex with him there while others watched. Pure science fiction, he replies: he organised romantic trips for her and once they visited a risqué club, in Paris, but both of them felt uncomfortable—and left.

A classic case of he said, she said, it would seem? The wretched Mr Ryan has done nothing illegal, and, even if true, the allegations may strike many voters in the post-Clinton era as relatively mild. Alas for Mr Ryan, the conservative wing of his party is unlikely to be so understanding. Meanwhile, he is also in trouble with the party bosses who claim that he misled them about the embarrassing nature of the files, which he had fought to keep sealed. There had been rumours that something juicy was in them during the primary, a contest in which Mr Ryan beat seven other candidates.

As *The Economist* went to press, Mr Ryan was vowing to fight on. But he was already well behind the arguably still more charismatic Democrat, Barack Obama, in the race for the seat now held by Peter Fitzgerald, a Republican who is not seeking re-election. The White House had shown interest in Mr Ryan's campaign; but Bush-Cheney officials indicated this week that they would shift their focus to other, more competitive races, at least until the controversy cools.

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Swing states: Michigan

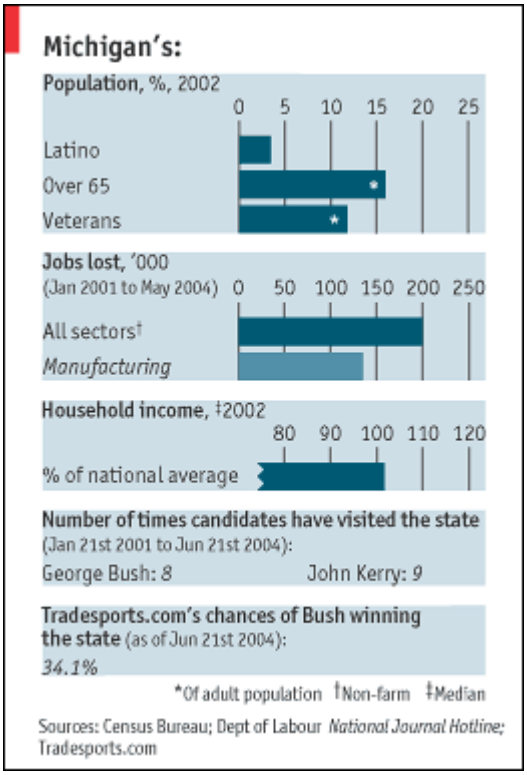
The battle by the lakes

Jun 24th 2004 | ANN ARBOR AND DETROIT
From The Economist print edition

George Bush is putting pressure on John Kerry in Michigan, but the economy still counts against the president

THE mood in Michigan is mostly bleak these days. Pessimists say it looks like just another rustbelt state on the wane. Its jobless rate of 6.5% is well above the national average. The steep rise in petrol prices is a particular blow for a state where everybody seems to own a car or a boat or be involved in making them.

There are bright spots, however. Optimists point out that the jobless rate is down from 7.2% a year ago. Despite all the whingeing about local politicians, a charismatic young Democratic governor, Jennifer Granholm, enjoys heady approval ratings. And in an omen of better times ahead, the Detroit Pistons, an underdog team from an underdog city, has just snatched the basketball championship from the glitzy Los Angeles Lakers.



Mood may matter a lot in Michigan—a classic swing state where factors like election-day weather can influence the outcome. It is also one of the biggest competitive states, with 17 electoral votes, and thus gets a lot of attention. Both parties have been running ads since February. Mr Kerry was in the state for the ninth time last week; a few days earlier Mr Bush sent his commerce secretary, Don Evans, to talk about the better job numbers.

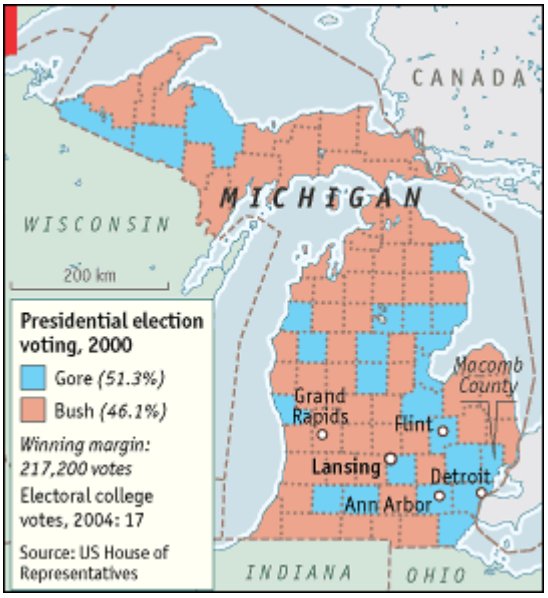
All the same, Mr Kerry plainly needs a win here more than Mr Bush does. The Democrats have carried the state in the past three presidential contests. The party controls the governorship and both Senate seats. The home of the United Auto Workers, Michigan is one of the states where unions still matter. Detroit, a predominantly black city, is a Democratic stronghold; so is Ann Arbor, a liberal university town.

Yet Mr Bush is plainly within a shout. He has solid support in the conservative western side of the state and also in the wealthier suburbs of Detroit. An EPIC-MRA poll issued this month showed Mr Kerry leading the president by only two points. A recent Zogby poll of swing states actually put Mr Bush ahead in Michigan.

So why isn't Mr Kerry doing better? As in so many states, his campaign has made a slow start. The campaign director, Donnie Fowler, a former campaign adviser to Al Gore and Wesley Clark, was appointed only this month. More generally, although the Democratic faithful loathe Mr Bush, they wonder about his opponent.

Take two of the groups that you would expect to be fully on Mr Kerry's side. The local unions, who favoured Dick Gephardt at first for the Democratic nomination, worry whether an environmentalist like Mr Kerry would be good for their factories.

Meanwhile, Arab-Americans, a big voting block in and around Detroit, may be disillusioned by Mr Bush's Middle East policies; but they are unsure whether Mr Kerry would be any better, and so some favour Ralph Nader. Meanwhile, Mr Bush's people are making concerted efforts to lure Indian-Americans, a group that has usually voted Democratic in the past.



The Republicans like to point out that Michigan is less Democratic than it first appears. Republicans control both houses of the state legislature. The state once voted reliably for Ronald Reagan, Richard Nixon and its native son, Gerald Ford. Lots of independent voters live in Michigan (around 16-19% of the electorate), and they sometimes vote Republican.

It is these independents, particularly suburban working women, that Governor Granholm has been particularly successful at rounding up for the Democrats. Mr Kerry obviously sees her as an asset; she has been invited to address the Democratic convention next month, and one senior figure in the White House even claims that Mr Kerry thought about her as an ideal running-mate (she is ineligible, having been born in Canada).

But Ms Granholm's prominence also underlines some differences with Mr Kerry. She is more of a Clintonian centrist and a populist than the patrician New England senator. Mr Bush's troops will try to convince blue-collar types in places like Macomb County that a “Harvard Yard liberal” of Mr Kerry's stripe does not share their values on issues like gay marriage.

Yet Mr Bush will get the attention of such voters only if he can convince them that the economy is recovering. Around 150,000 manufacturing jobs have been lost since early 2001. Outsourcing is often seen as the culprit (even though a report issued this month at the Mackinac Policy Conference suggested that it accounted for only one in eight of the jobs lost). Mr Kerry's talk about Benedict Arnold corporations exporting American jobs goes down well in the rustbelt.

The economic pain may be most obvious in Detroit and its suburbs (home to more than 40% of Michigan's population), but it is actually spread across the state. In the west, the furniture-making industry has been hurt by cheap foreign competition; in the remote Upper Peninsula, mining and forestry are both in trouble. Another problem has been the cuts in local and state budgets. Ed Sarpolus, a pollster, reckons a third of companies rely on contracts with local government.

Yet Mr Bush is not without hope on this score. Manufacturing jobs are now holding steady. A high-tech corridor is being fashioned. Service industries—notably tourism—are picking up. There has been a property boom on the state's north-western edge along Lake Michigan, as residents from nearby states and retirees (many of them former car-workers) move north in search of the good life. Democrats point out that these exiles from the city are usually on their side. But Mr Kerry's hold on the state may depend rather more than he would like on that hovering cloud of economic gloom.

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Poor George

Jun 24th 2004
From The Economist print edition

The case for pessimism about the president's prospects

Get article background

FOR six months, conventional wisdom in Washington, DC, has held that George Bush's popularity is more buoyant than you would expect considering the political pounding he has taken on Iraq, the number of jobs lost in his presidency, and so on. Republicans everywhere have taken comfort in the fact that John Kerry's lead in the polls, when it has existed at all, has been a fairly small one. But what if that wisdom needs to be turned on its head? What if the president's numbers were weaker than you would have expected considering the amount of good news he has enjoyed?

Over the past few weeks, the economy has been roaring back. Mr Bush has won international support for handing over sovereignty in Iraq. The funeral of Ronald Reagan was a week of respectful observance for the last sword-wielding, tax-cutting conservative. Mr Bush has spent $100m on advertising, much of it aimed at Mr Kerry's solar plexus. Yet Mr Kerry is still in the lead, and Mr Bush's poll numbers seem to be going through the floor.

If you put all the bad news together—which this column will do this week—you can make an argument that Mr Bush is in real political danger. That does not mean he is inevitably going to lose; there are still four months to go, Mr Kerry is still unproven and most sane people still think the race will be extremely close. Yet if Mr Kerry were to win in November, mid-June is likely to be seen in retrospect as the point where the president began to lose the White House.

The most striking finding in a new poll by the *Washington Post* is that only 39% of respondents are willing to describe the president as honest and trustworthy, while 52% describe Mr Kerry that way. Republican optimists will argue that this is just an aberration. But there are grounds for thinking this finding is rooted in real political events: in the administration's confident assertion that there were weapons of mass destruction in Iraq; in its insistence that the abuses in Abu Ghraib prison were caused by a few bad apples; in its claim that the cost of last year's Medicare reform bill would be $400 billion, not (in reality) $550 billion. Trust is essential for good government. It is also the quality Mr Bush stressed above others to distinguish his administration from Bill Clinton's. He is in danger of losing voters' trust.

The pollsters' economic findings should also worry Mr Bush. After a period of the fastest sustained growth since 1984, and with job creation recently averaging 300,000 a month, well over half of respondents still

think the state of the economy is poor. Mr Bush's people say this reflects a natural lag of perceptions behind reality. But growth has been going on for 30 months, and other indicators of recovery have been visible at least since the start of this year, so the lag is already unusually prolonged. Unless perceptions change soon, they could become entrenched, and then any amount of good news in September and October will come too late.

It is at least possible that voters are getting into a mood where they are simply refusing to hear good news. They will not give Mr Bush any credit for recovery, just as in 2000 they refused to give Al Gore credit for the Clinton boom. One explanation could, bizarrely, be Iraq. Judgments on the economy may well be overshadowed by pessimism about the occupation; views on these two largely unrelated subjects seem to move in close correlation.

Whatever the reason, there is a great deal of evidence that voters are in a huff. Every poll shows the right track-wrong track indicator—the so-called Dow Jones of politics—moving alarmingly against the incumbent: around 20% more Americans think the country is on the wrong track than those who think it is on the right one. The other mainstay of political forecasting, the president's approval rating, is stuck around 45%; the rule of thumb is that incumbents need slightly over 50% to win. On most individual issues, Mr Bush is doing even worse—proof, Republicans argue, that their man is greater than the sum of his parts, but even they must be scared by the headline figure from the *Washington Post* poll, which showed that Mr Bush has lost his lead over the challenger in his signature area, conduct of the war on terror.

A drama in three stages

Most presidential campaigns are three-act dramas. Act I is a referendum on the incumbent. Voters look at the president and ask “Does he deserve four more years?” If the answer is a clear yes—as in 1984 or 1996—it barely matters who the challenger is; he may as well go home. This stage lasts until the party conventions. Assuming voters have not definitively decided on re-election—and, manifestly, they have not this time—Act II starts with the conventions and runs until about September. Voters then turn their attention to the challenger: is he ready for prime time? If he is, Act III, the real horse race, begins in September with the presidential debates. Then, and only then, do the head-to-head comparisons matter.

All that means Mr Bush has time to recover from his current woes. Voters have barely begun to look at Mr Kerry, let alone make direct comparisons with Mr Bush. And events may yet play a big role in determining the outcome of the vote. The publication of the September 11th commission's report on the eve of the Democratic convention may help Mr Kerry. Better news from Iraq, or (God forbid) an attack by al-Qaeda would almost certainly help Mr Bush.

But it is clear that Mr Bush has done worse in Act I than an incumbent should. His crown sits all the more uneasily because the polls suggest that the vast majority of voters have already made up their minds (only one in ten say they are undecided). If he is to triumph in Act III, Mr Bush has a lot of crowd-pleasing to do. Mid-June might mark his electoral nadir; but it might also be seen as the beginning of the end of the Bush presidency.

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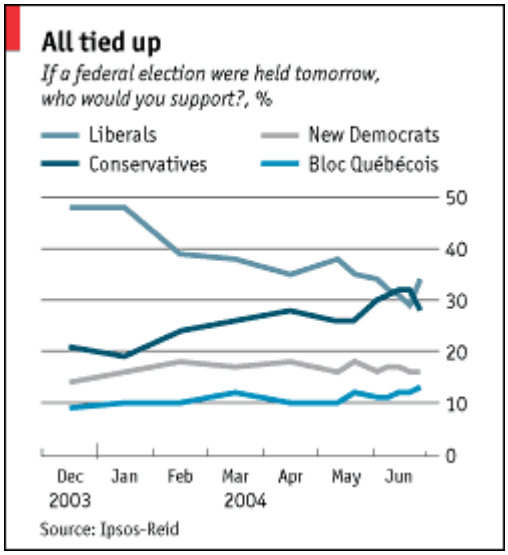
Canada's election

Harper and Martin: down to the wire

Jun 24th 2004 | TORONTO AND VANCOUVER
From The Economist print edition

A campaign that turns on the balance between anger and fear of change

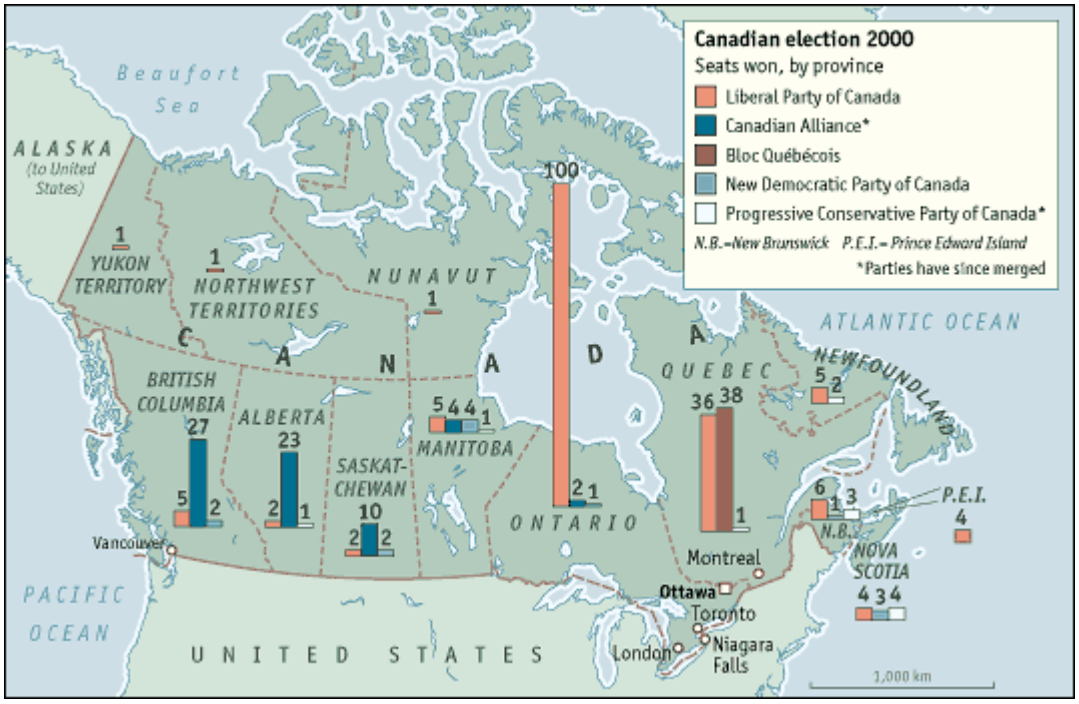
Get article background



SIX months ago, the civil servants and immigrants who make up many of the voters in Ottawa South seemed sure to choose David McGuinty as their next Liberal member of Parliament. The seat has been held for 16 years by John Manley, a former Liberal deputy prime minister. Mr McGuinty's father represented the constituency for many years in Ontario's provincial legislature, and his older brother Dalton swept to office last October to become the first Liberal premier in Canada's most populous province in more than a decade.

Yet, as in many other places, the Liberals can no longer count on winning Ottawa South on June 28th, in Canada's most tightly fought general election in years. In the final week of the campaign, the Liberal support rallied (see chart). But the polls have been volatile, voters are in surly mood and a fifth of them remain undecided. So the Liberals will be hugely relieved if they can scrape up enough seats to form a minority government.

Their chances of doing so depend on how they fare in Canada's three main population centres: Ontario, Quebec and the west. Compared with the last election in 2000 (see map), the Liberals have lost popularity in all three, but in each case for slightly different reasons.



Ontario is the biggest battleground. Since calling the election on May 23rd, Paul Martin, the prime

minister and Liberal leader, has had to spend far more time in the province than his strategists had planned. He was there again this week, struggling to turn back a Conservative tide which has engulfed a swathe of small cities and rural areas across the centre of the province, from the outskirts of Ottawa in the east to Niagara Falls in the south and the university town of London in the west.

At the last election, the opposition's divisions denied them seats in Ontario. This time, the merged Conservative Party could snatch up to 50 seats in the province, according to John Wright of Ipsos-Reid, a Toronto polling firm.

Far from being an asset, the McGuinty name has turned into a millstone for the Liberals, and not just in Ottawa South. Support for the Conservatives rocketed in late May after Dalton McGuinty broke a campaign promise to balance the province's books without raising taxes. He has imposed a “health premium” of C$50 ($37) a month on the average Ontario family to help finance ballooning Medicare costs. “Voters are tired of people who say one thing before they're elected and another after they're elected,” says Alan Riddell, a bilingual labour lawyer who is the Conservative candidate in Ottawa South. He is given a good chance of winning.

The Liberals are also paying a price for Mr Martin's drive to grab the top job from his fellow-Liberal predecessor, Jean Chrétien and, having done so, to ostracise his supporters. The Martin team's heavy-handed tactics have alienated local Liberal officials and volunteers. For example, the party executive in one Toronto constituency previously held by Mr Chrétien's industry minister were dumbstruck when a Martin supporter showed up at the nomination meeting with 6,000 signatures. He won the nomination, but will be lucky to win the election. Few Chrétien supporters have stepped forward to man phones or stuff envelopes in the campaign office.

A surprise is the loosening Liberal grip on the political loyalty of immigrant Canadians. The Liberals have traditionally favoured immigration (including that of family members), and have doled out subsidies for an array of multicultural causes. But many among Ottawa South's large Muslim population are likely to cast their ballots next Monday for Monia Mazigh, of the left-leaning New Democratic Party (NDP). Tunisian-born, she led a successful campaign last year to win the release of her husband who was deported by the United States to Syria as a suspected terrorist.

The NDP, under an energetic but garrulous new leader, Jack Layton, had hopes of a breakthrough in this election. But it may fall short of its target of ten seats in Ontario. There were signs that fear of a Conservative victory was driving leftish voters to the Liberal fold.

In Quebec, the Liberals were hoping that similar fears would blunt what looked like an impending massacre. One poll this week had Liberal support in the province plunging to 26%, against 50% for the separatist Bloc Québécois. The Liberals could lose up to a score of seats in the province. But the outcome may not reflect a wider resurrection of support for secession in Quebec. Richard Schultz, a political scientist at McGill University in Montreal, points out that the Bloc has not made sovereignty an issue in the election. He says a defeat for the federal Liberals might even help Jean Charest's unpopular Liberal government in the province, allowing him to blame problems on Ottawa.

In western Canada, voters are accustomed to feeling like irrelevant bystanders: timezones mean that the election's outcome is usually determined before their votes have been counted. Not this time. The balance of power in Ottawa may depend on a three-way dogfight in British Columbia, where the latest poll gives the Conservatives 36%, ahead of the Liberals (28%) and NDP (26%). That has forced candidates to return to old-time campaigning, knocking on doors and holding local candidate debates.

Mr Martin has drafted in two prominent recruits, David Emerson, a former businessman, and Ujjal Dosanjh, British Columbia's former NDP premier. He has also offered C$450m in extra money to help fix Vancouver's transport problems. But that is unlikely to assuage westerners' gripes about being ignored by Ottawa, nor break the Conservative ascendancy west of the Prairies.

Across Canada, the election has turned into a contest between fear and anger. Mr Harper has professed moderation on social and economic issues. He would devolve more power to the provinces. More controversially, he would pull out of the Kyoto protocol. Outside his political base of Alberta, many fear that his new party has inherited the social conservatism of its chief forebear, the Canadian Alliance. They worry that Mr Harper would make Canada more like the United States.

On the other hand, Mr Harper's assault on the Liberals' “waste, mismanagement and corruption” has struck a chord with many voters. Whether their anger at the Liberals will be enough to outweigh their

fear of change may not be clear until the last British Columbian votes are tallied.

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Electoral law in Mexico

Vote, sweet vote

Jun 24th 2004 | CHICAGO AND MEXICO CITY
From The Economist print edition

Mexicans agree that expats should vote—but how?

Get article background

ON THE eve of a trip to the United States last week, President Vicente Fox dusted off an old campaign promise: on June 15th he sent his Congress a bill which would give some Mexicans living abroad the right to vote for president ahead of an election in 2006. Approval ought to be easy. Public opinion is not unfavourable, the three main parties all claim the idea was really theirs, and the electoral authorities say they are keen to put it into practice. But there are daunting practical difficulties: 10m Mexicans live in the United States alone. Allowing even some of them to vote would amount to an unprecedented experiment in absentee balloting.

Mexico changed its constitution in 1996 to allow émigré nationals (who can hold dual citizenship) to vote, but the change cannot be implemented without an enabling law. Mr Fox's delay in introducing one was criticised by leaders of Mexican communities in the United States, many of whose members had welcomed his defeat of the long-ruling Institutional Revolutionary Party (PRI) in 2000.

Reuters

Fox and a future absentee voter

Voting rights for Mexican-Americans might assuage frustration at home over Mr Fox's failure to achieve a migration accord with the United States—while also recognising the vital contribution of remittances ($13 billion last year) to Mexico's economy and its relative social peace.

The three main parties had agreed in April to try to enact legislation for émigré voting by 2006. Even the PRI, still the largest party in Congress, signed up; it had blocked previous attempts, fearing migrants' presumed antagonism to it. But recent studies indicate that the allegiances of migrants are more fluid than previously thought. The most enthusiastic supporter of the idea is the left-leaning Party of the Democratic Revolution. It has promoted absentee voting since 1988, and has branches in five American states. It sees Mr Fox's bill as merely a first step.

That it is: voting would be for president only, not for Congress; it would be restricted to migrants with voter-registration cards. At most, only 1.5m of up to 9m adult Mexicans living in the United States are thought to hold these. Since most of those lacking them are illegal migrants, they are unlikely to make the hazardous double journey to register and go north again.

The bill's proposed ban on campaigning by Mexican candidates north of the border flies in the face of reality. Mexican-American communities are regularly visited by politicians who hope they will influence friends and family back home. A forthcoming election for governor of Zacatecas state has drawn a string of candidates to Chicago, for instance. But Mr Fox's conservative National Action Party, which enjoys less sympathy in the United States than the president (who has often campaigned there), is unlikely to budge on the campaigning ban. Without it, officials point out, it would be impossible to enforce legal restrictions on foreign campaign financing.

Florencio Zaragoza, of the Arizona branch of the Coalition for the Political Rights of Mexicans Abroad, welcomes the Fox plan, though his group wants other rights too, including that of election to office in Mexico. The Fox bill “will be easier for Congress to agree upon,” he says. Nevertheless, he hopes it will

set a precedent for further political rights.

Many Mexican political analysts are sceptical about the bill's prospects. It suggests three possible voting mechanisms: mobile polling stations, internet voting and postal ballots. It leaves the final decision to the Federal Electoral Institute. But the institute is likely to insist that Congress must decide. That could spell endless debate—not least because Mexico had a long tradition of electoral fraud, ended only recently. Another stumbling block is the potentially huge cost of organising an election abroad. Mexicans are already fed up at the 13 billion pesos ($1.37 billion) of public money spent on the presidential election of 2000.

None of this bodes well for the bill. Mr Fox has hitherto shown little ability to get legislation through the opposition-dominated Congress. The next election is two years off—but that may still be too soon for the political aspirations of Mexican-Americans to be fulfilled at last.

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Politics in Brazil

Wages of bumbling

Jun 24th 2004 | SÃO PAULO
From The Economist print edition

Lula's frayed relations with Congress

Reuters

Get article background

For those who toil—and those who don't

IT WAS perhaps the biggest political defeat for Luiz Inácio Lula da Silva since he became president 18 months ago. On June 17th the Senate backed a larger rise in the minimum wage than Mr da Silva wanted: to 275 reais ($88) a month rather than to 260. Since the higher wage automatically forces up pension payments to many better-off Brazilians, the vote was bad for shaky public finances as well as reflecting ill on Mr da Silva's ability to govern.

Knowing financial markets might tumble on the news, the Senate reassured them by approving a much-needed new bankruptcy law on the same day as the minimum-wage vote. Congress's lower house duly restored the president's proposal for the minimum wage this week. But that does not mean that the government has regained command of Congress—or that investors can relax.

The Senate defeat was the product of shameless politicking and a bumbling response by the government. The opposition, in this case led by the conservative Liberal Front Party, demanded an unaffordable minimum wage purely to embarrass a left-wing president who had once promised to double it. The government's allies were in disarray. José Sarney, the Senate president, was annoyed that Lula's people did not back vigorously a measure allowing him (and the president of the lower house) to run for a second term. Lula's top adviser, José Dirceu, is said to be feuding with Aldo Rebelo, who succeeded him as liaison man with Congress. In general, says Christopher Garman, a political scientist at Tendências, a consultancy, the government's relationship with Congress, especially the Senate, has been “very poorly managed”.

Attention will now shift to three factors over which Lula has even less control. First, the Supreme Court will rule shortly on the constitutionality of a reform of public-sector pensions—crucial for containing public debt. A ruling to overturn taxation of retired civil servants “would be very negative,” says Mário Mesquita, of the Brazil office of ABN-AMRO, a Dutch bank. A mooted government backup plan would require congressional approval.

The second factor, the economy, looks brighter. It grew at an annual rate of more than 6% between January and March; it is expected to grow by up to 4% for the year as a whole. The doubt is whether wages and jobs will recover fast enough to help Lula's Workers' Party (PT) with the third hurdle, October's municipal elections. If the PT fares poorly and the economy falters, pressure to loosen fiscal and monetary policy “will rise tremendously”, says Mr Garman. Campaigns are only just starting, and in many local politics will play a big role. But the latest opinion poll offers little comfort to the PT: respondents judging Lula's government as “good” or “excellent” dropped five percentage points between May and June, to 29%—doubtless in part because of the opposition's manoeuvre over the minimum wage.

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The oil industry in Ecuador

Keep your investment money

Jun 24th 2004 | QUITO
From The Economist print edition

Even though we need it

Get article background

IT MAY or may not be a sign of a healthy marriage when a president's wife votes against his proposals in Congress, but it certainly bodes ill for government policy. In a vote on June 16th, Ximena Bohórquez, the wife of President Lucio Gutiérrez and herself a congresswoman for his party, joined the opposition to help kill a government-backed bill that would have funnelled private capital to the struggling state-dominated oil industry. Its defeat is bad news for Ecuador's economy.

Oil provides 40% of Ecuador's export earnings and a third of government revenue. The opening last year of a new privately financed oil pipeline, more than doubling transport capacity just when prices were high, was supposed to usher in a new oil boom. But while oil production by private companies has increased threefold during the last decade, output from Petroecuador, the state oil firm, has dropped by almost 40%. Petroecuador is hobbled by lack of investment, corruption and bureaucracy.

Mr Gutiérrez, who campaigned for president as a populist, has embraced economic orthodoxy since taking office in January 2003. The oil reform would have legalised joint ventures between private firms and Petrocuador in the state firm's oilfields. But this was opposed by the powerful oil workers' union, and a host of leftist groups. The government will try again: it plans to issue a weaker version of the bill under a curious provision in Ecuador's constitution that allows automatic approval unless Congress rejects it in 30 days. That may prompt the legislature to act with uncharacteristic alacrity.

Meanwhile, Ecuadoreans can only rue what they are missing. Had Petroecuador produced last year what it did in 1994, its export income from its own fields would have been $1.2 billion—or almost three times the actual figure. Oil reform would also counter a widespread perception that Mr Gutiérrez is losing his grip on events. On June 1st, his respected finance minister, Mauricio Pozo, resigned for “personal reasons”. His replacement, Mauricio Yépez, is similarly orthodox. Without oil reform, he said, it was not worth going to Washington to talk to the IMF about a new loan.

Even so, Mr Gutiérrez, a former army colonel, might be relieved that his problems are not even more serious. Last month, the conservative Social Christians, who have hitherto backed the government's economic policy, hinted that they might join the left in seeking to impeach the hapless president.

Mr Gutiérrez is Ecuador's sixth president in seven years. No useful purpose would be served in removing him early. The political noise has quietened for now, after a sharp reminder from the American ambassador that the country should “maintain democracy”. But for how long? Mr Gutiérrez is abhorred by his former allies on the left, while the Social Christians are no more than fair-weather friends. But almost everyone in Ecuadorean politics has their price. The president may find ways to survive. But the country continues to pay for its political failings.

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China

Peaceful rise

Jun 24th 2004 | BEIJING
From The Economist print edition

Even when China is trying hard to be conciliatory, it scares its neighbours

Get article background

CHINA spends a lot of time worrying about what other countries think of it. So the country's rapid economic growth in recent years has given it a particularly nasty headache. How can China deal with foreign concerns, especially in Asia and the West, that the country's economic strength will one day encourage it to assert its power aggressively, or even militarily?

In the last few months, China has started to develop a riposte. This was first clearly enunciated at a luxury hotel on the tropical Chinese island of Hainan last November. There, delegates to the Boao Forum, an economic conference attended by many Asian leaders, were informed by a senior Communist Party official that “our choice can only be to strive to rise; and what's more this is a peaceful rise.” Since then, the catchphrase “peaceful rise” has become something of a favourite.

It may sound like a bland rephrasing of the frequent Chinese assertion that the country is peace-loving and will “never seek hegemony”. But the new formulation, repeated most notably by China's prime minister, Wen Jiabao, during a visit to America in December, has aroused considerable debate in China—and from both directions. Is it right, ask some, to use the word “rise” at all, since it might cause the wary to draw parallels with the rise of Germany or Japan? Does not the history of the last century suggest that the rise of big powers inevitably leads them into conflict with other powers? Or, from the opposite perspective, is it really appropriate to use the word “peaceful”, given that China reserves the right to use force against a recalcitrant Taiwan?

Since taking up their posts early last year, Mr Wen and President Hu Jintao have been busy trying to present China as a benign emerging nation that is ready to co-operate with others to solve international problems. In Asia, despite historical misgivings about Chinese power, the country's growing clout as an engine of regional economic growth is helping China strengthen its diplomatic influence. A few friendly gestures have helped. Late last year, China signed a “treaty of amity and co-operation” with the ten-member Association of South-East Asian Nations: the first non-South-East Asian country to do so. It also signed a code of conduct aimed at reducing the risk of conflict over territorial disputes in the South China Sea.

In Central Asia, China has promoted a relatively new security forum, the Shanghai Co-operation Organisation, aimed at strengthening border security and countering Islamic extremism (and also, some suspect, aimed at countering western influence in the region). In North-East Asia, China has won much praise, not least from the Americans, for its hosting of six-nation talks aimed at resolving the nuclear issue in North Korea. A third round of these talks opened in Beijing this week. China is touting the idea of turning the grouping into a permanent forum for handling broader security issues in the region.

All this would seem to fit the bill of a “peaceful rise”. Even so, there are some signs that America resents the diplomatic inroads China has made in Asia. James Kelly, an American assistant secretary of state responsible for the region, said this month that in some areas China was challenging the status quo “aggressively”. A bipartisan report by the American Congress raised similar fears last week. But China has not tried to mount a direct challenge to American power. On the contrary, it has sought to avoid confrontation with the United States, despite considerable misgivings about American “unilateralism” and strongly-felt differences over a host of issues from Taiwan to human rights.

But can this last for ever? Kenneth Lieberthal of the University of Michigan, who served on America's National Security Council under President Clinton, sees the leadership's focus on the concept as encouraging. “I think the presumption is that if you take on America frontally you aren't going to grow wealthy and strong because there's such a chasm in terms of capacity, economic and military,” he says. He thinks that Chinese analysts now appear less certain of the imminence of a “multipolar” world order than they did at the end of the cold war. More now accept that America is even stronger.

While China may grudgingly recognise this, it could still find itself confronting America over an increasingly independence-minded Taiwan. A Pentagon report published last month says that the Chinese military's focus on preparing for conflict in the Taiwan Strait “casts a cloud” over China's declared policy of seeking peaceful reunification with the island. William Callahan of Britain's Durham University argues that the peaceful-rise notion could be read as a hidden threat. Should the world not recognise China's new status, runs the implication, an upswell in Chinese nationalism will result.

This reading would not be pleasing to the concept's inventors. The term “peaceful rise” was invented at the Central Party School, the training ground for senior leaders, in response to what China calls the “China threat theory”. But it appears that others now worry that the term might actually play into the hands of China's critics, some of the more strident of whom shudder at the mere mention of the word “rise” in connection with China. Western diplomats in Beijing say some Chinese Foreign Ministry officials have appeared distinctly unenthusiastic about the concept.

Even President Hu, despite using the words “peace” or “peaceful” 11 times in an address at another Boao Forum meeting in April, did not use the word “rise” at all—a point that was noted by the official news agency, Xinhua. To make the term more palatable, Chinese officials now say China's rise could take generations. Deciding what exactly the notion means and how it might be possible to achieve it could take just as long.

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South Korea and Iraq

Murder and its consequences

Jun 24th 2004 | SEOUL
From The Economist print edition

President Roh refuses to let a beheading change his foreign policy

EPA

The people still oppose the Iraq war

Get article background

THE killing of a young South Korean by Islamic extremists in Iraq was met this week with shock and outrage at home. Kim Sun-il, a translator with a Korean trading company based in Baghdad, was beheaded by militants linked to an alleged al-Qaeda terrorist, Abu Musab al-Zarqawi. The government in Seoul bluntly refused his captors' demands to reverse its plan to send some 3,000 additional soldiers to the country. But despite the outrage, the murder seems certain to increase opposition to the planned reinforcement.

This deployment, now due to begin in August, had already been delayed once in the face of deteriorating security in Iraq and fierce criticism at home. But the president, Roh Moo-hyun, has remained resolute. He has shown no inclination to renege on his agreement to an American request for additional military help, even though his government has emphasised that its expeditionary force will be involved only in rebuilding, not in combat. Immediately after news of Mr Kim's killing, Mr Roh convened an emergency meeting of his National Security Council, which reaffirmed the plan. The extra troops will join more than 600 military medics and engineers, and will be based near the Kurdish-controlled town of Arbil. But all non-essential South Korean civilians are being evacuated.

Mr Roh appears to believe that the operation serves the larger interests of a country whose foreign policy is founded upon its alliance with the United States. He has linked the deployment to what he sees as signs of a softer line from America towards North Korea in talks aimed at dismantling Pyongyang's nuclear-weapons programme. This is closer to his own policy of engaging rather than confronting the unpredictable dictatorship to the north. (As it happened, Mr Kim's death almost coincided with the start of a third round of multilateral talks in Beijing over how to deal with the North's nuclear ambitions.)

But Mr Roh's strategy holds considerable political dangers at home. He risks alienating his core supporters, who are strongly opposed to the American invasion of Iraq, while finding only grudging favour from his conservative opponents. By coming into office on a pledge to pursue a more independent foreign policy, but in practice sticking close to the superpower, Mr Roh has managed to alienate people on all sides of the debate.

The murder of Kim Sun-il also brings into focus the broader issue of his country's global role. Many South Koreans increasingly aspire to a place in the world that seems more in keeping with their position as

citizens of its 12th largest economy. But, as the shock and revulsion at Mr Kim's murder demonstrates, the people of a traditionally insular country are only just beginning to understand the costs such a pretension involves.

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India and Pakistan

Good neighbours, but going where?

Jun 24th 2004 | DELHI
From The Economist print edition

Though détente survives India's election, a Kashmir peace is still elusive

AP

When Kurshid met Natwar

CHANGING partners is never entirely easy. The peace process between India and Pakistan has endured something of a rocky patch since its principal architect, Atal Behari Vajpayee, India's former prime minister, lost an election last month. A flurry of meetings with the new Congress-party led government has now reassured Pakistan that India remains committed to the path of dialogue. What remains in doubt is whether that path actually leads anywhere.

On June 20th, officials from the two countries produced a joint statement on measures to build confidence over their respective nuclear arsenals. This was part of a series of talks agreed to in February, covering all bilateral disputes, including the intertwined issues of terrorism and Kashmir, which seemed to bring the neighbours to the brink of war in 2002.

The day after the talks, India's new foreign minister, Natwar Singh, and his Pakistani counterpart, Khurshid Kasuri, had a chummy lunch on the margins of a regional conference in Qingdao, China. Progress was also being made in talks about a contentious hydro-electric project in Indian-administered Kashmir. On June 27th, the heads of the countries' diplomatic services are to meet and broach the subject of Kashmir. The foreign ministers will meet again next month at another conference, and then, in August, sit down for serious bilateral talks to review progress so far.

In opposition, the Congress party last year supported Mr Vajpayee's offer of the “hand of friendship” to Pakistan. Pakistani officials were at first nonetheless suspicious of the new government's foreign-policy team. It is dominated by crusty former diplomats, such as Mr Singh himself, who rattled Pakistan by making repeated references to the 1972 Simla agreement between the two countries. In Islamabad, this was taken to mean that India ruled out any change in its policy on Kashmir.

Mr Singh has since backed down, or, as his officials prefer it, cleared up the misunderstanding caused by inaccurate reporting of his remarks. After initial misgivings, says Khalid Mahmud of the Institute of Regional Studies, a think-tank in Islamabad, Pakistan has now concluded that Congress may actually prove to be a more consistent partner than was the whimsical Bharatiya Janata Party (BJP) with its occasional warmongering.

So the marked improvement in relations seen in the final months of the BJP government persists. The problem is that little concrete has been achieved so far. The risk-reduction agreement covering nuclear

weapons is welcomed by foreign governments worried about the risks of nuclear accidents, or of the rapid escalation of a conventional war. But it is largely symbolic. With the exception of an agreement to set up a new telephone hotline between the two foreign ministries (in itself only of symbolic value), it mostly formalises existing practice. This includes a moratorium on further nuclear explosions, and arrangements for one side notifying the other of missile tests.

Such confidence-building measures will not satisfy Pakistan for long if there continues to be little sign that India is prepared to talk seriously about Kashmir. And, despite weariness with the 15-year long war, the moderate separatists in Kashmir itself, who are prepared at present to talk to India, may also lose patience.

India acknowledges that far fewer militants are infiltrating Indian-controlled Kashmir, but claims that 4,000 are camped on the Pakistani side ready to cross, now the snows have melted. Even without them, the violence continues. According to India's own figures, 1,000 people were killed in the first five months of the year. The risks taken by moderates were highlighted on May 29th by the killing in a mosque in Srinagar, the state's summer capital, of Mushtaq Ahmed. He was cousin and close adviser to Umar Farooq, a senior cleric and part of a group of separatist leaders who have been engaged in talks with the Delhi government.

That dialogue, started in January, has been stalled because of the elections. India's home minister, Shivraj Patil, has acknowledged that India needs to reward separatists prepared to talk peace. But the government will not want to lay itself open to charges of being soft on terrorism. Already, the BJP has attacked this aspect of its policy. At its national-executive meeting this week in Mumbai, the moderate Mr Vajpayee hinted at retirement, while hardliners reasserted the party's Hindu-nationalist roots. That means promoting “Hindutva” or “Hinduness”. It also usually means bashing Pakistan.

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Kazakhstan

Democratic change

Jun 24th 2004 | ALMATY
From The Economist print edition

A new political era?

KAZAKHSTAN'S authoritarian president, Nursultan Nazarbaev, has decreed that parliamentary elections will be held on September 19th. The outcome of the poll—and, just as importantly, how it will be conducted—will indicate whether the oil-rich Central-Asian state is now ready to extend reform beyond economics to the political sphere.

Kazakhstan's politics have so far largely revolved around Mr Nazarbaev, his powerful family and a few rich businessmen. Aside from Asar, the party created last year by Mr Nazarbaev's daughter, Dariga, there are at least three other pro-presidential parties. Yet the rapidly growing middle class, which is demanding greater representation, is increasingly turning to moderate reformers. These are mostly former government officials and businessmen who created a new party, Ak Zhol, two years ago. More radical reformers from the Democratic Choice of Kazakhstan favour a parliamentary system, rather than, as at present, a presidential one.

How much popular support the 12 competing parties really have is hard to gauge. Previous elections have not been free or fair. There are hardly any independent media. A poll by the Association of Sociologists and Political Scientists cited Asar, Ak Zhol, and the pro-presidential party Otan as the clear front runners.

All the same, change may be in the air. Although its leader is still behind bars, Democratic Choice was recently and unexpectedly registered as a political party. Over the last few months, improvements have been made to the electoral system. The composition of the election commission has been changed, and an electronic-voting system has been introduced. And last week, Mr Nazarbaev also announced that the new parliament, in the past a mere rubber-stamp, will be getting greater powers. This time, it might actually be worth voting for.

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The Philippines

Bad losers

Jun 24th 2004 | MANILA
From The Economist print edition

Gloria Arroyo has finally been re-elected

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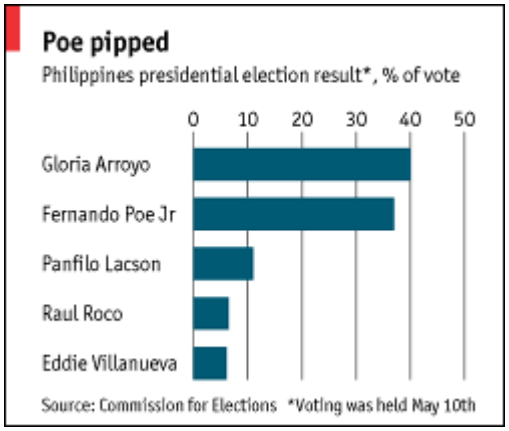

APPALLING traffic jams are nothing new in Manila. But on the morning of June 21st, the city's commuters faced more than the usual chaos, when a disgruntled candidate for president scattered hundreds of metal spikes across the city's main roads, causing at least 160 flat tyres. The culprit, Elly Pamatong, wants America to annex the Philippines as its 51st state; he was disqualified long before last month's election as a nuisance candidate. But his protest seemed both timely and apt, since Congress had not yet managed to announce the results, more than 40 days after the election, thanks to gridlock of a different sort. Indeed, Mr Pamatong's little snarl-up pales next to the political disruption caused by supporters of Fernando Poe Junior, the presumed loser of the race.

The winner, according to the congressional committee that totted up the returns, is Gloria Arroyo, the incumbent president. But Mr Poe, a matinee idol and high-school drop-out, says she rigged the vote. His allies on the committee demanded that it examine not just the summary of returns from the different provinces and municipalities, but also the original tally sheets from individual polling stations. The president's supporters, who had a majority on the committee, refused, arguing that such a detailed recount could not be completed by June 30th, when the new president is due to be sworn in. So Mr Poe's partisans resorted instead to stalling the proceedings by disputing the results from each province and harping on about minor discrepancies. One opposition senator slowed things down by haranguing the committee for four hours.

In the end, however, the majority prevailed. Early in the morning of June 24th, after an all-night debate, a full session of Congress finally approved the committee's findings and declared Mrs Arroyo the victor, despite Mr Poe's continued protests. As a histrionic statement from his party put it, “What the majority in Congress has done is to abort the truth in the womb of our sacred electoral process.”

Elections are a dirty business in the Philippines, and Mrs Arroyo's supporters privately concede that the opposition probably would have found evidence of tampering if Congress had accepted its demands for a more thorough review. Indeed, in at least one precinct, she won more votes than there were voters, according to a member of her own slate. But Mr Poe is assumed to have used similar tactics—and cheating probably did not occur on a sufficient scale to account for Mrs Arroyo's winning margin of over 1m votes. Panfilo Lacson, another candidate, has accepted her victory, saying that any candidate who did not attempt to prevent ballot-rigging as it occurred deserved to lose the race. NAMFREL, a respected monitoring group, has said that there was no systematic fraud. Mr Poe himself has cast doubt on the merits of his case by refusing to challenge the results officially.

In fact, Norberto Gonzales, the national security adviser, argues that Mr Poe's supporters do not really expect to overturn the result, but rather to engender doubts about Mrs Arroyo's legitimacy, and so limit her effectiveness in office. He says that they will continue to sue and protest for another year or so—without success. Such endless carping, however, might distract Mrs Arroyo from her promised reforms, including efforts to raise revenue, cut the budget deficit, overhaul the constitution and automate elections. In recent years, legislation has crawled through Congress even more slowly than traffic through Manila—and the current electoral wrangle is preventing Mrs Arroyo from making a racing start.

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China

A bear's dream

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From The Economist print edition

A controversial move

“ALL zoos are animal prisons, but Beijing Zoo seems like death row.” So the 2002 Lonely Planet guide to China describes one of the very few public works of the imperial era that is still being used for the same purpose today. Its days, however, could now be numbered. Plans are afoot to move the 96-year-old attraction far beyond the urban area. Yet the city government—used to making big decisions without telling the public—has met stiff resistance.

Although it may be a dismal thought for the guidebook's authors—who conclude that “the polar bears must pin all their hopes on graduating from their concrete hell to the marvellous Beijing Aquarium”—the zoo is nonetheless hugely popular among visitors from around the country. And oddly, perhaps, in a city where grotesque planning decisions are often made with scarcely a murmur from the public, the fate of the zoo has turned into a hotly contested issue. Even the state-owned media have sided with critics of the government who want the zoo to stay where it is.

The government has said little since word of its secret decision leaked out on a Chinese website run by a private environmental group a couple of months ago. According to Chinese media reports, even the zoo was initially kept in the dark. The pretext for moving it was to protect public health (prompted by concerns about the animal origins of SARS—the respiratory disease—and bird flu), improve traffic conditions and give the animals more space. But some suspected that the potential value of a large piece of land in a fast developing area of Beijing was a powerful incentive.

Lawyers, academics and environmentalists have been holding meetings and circulating petitions. Interestingly, much of the debate has focused on the way the decision was made and the need for greater public oversight of the government. One prominent opponent of the move, Chen Yueqin, a lawyer, describes the government's decision as “illegal”, arguing that Chinese law requires public scrutiny of major projects. “We should develop a notion of doing things according to the law,” she says. Ms Chen draws comfort from that fact that Shanghai dropped similar plans after a public debate. If Beijing follows suit, the bears may have to dream on.

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Zimbabwe

The method behind Mugabe's madness

Jun 24th 2004 | HARARE
From The Economist print edition

Why Zimbabwe's leader wants to drive away his middle class and keep a frightened and starving peasantry in his thrall

Reuters

Get article background

YOU have to admire Robert Mugabe's chutzpah. First he makes life so miserable for Zimbabweans that busloads of them emigrate. Then he asks the fugitives to send money home to prop up the regime that drove them out in the first place.

Gideon Gono, the governor of Zimbabwe's central bank, has been on a world tour to persuade expatriate Zimbabweans to wire money home using official channels. Most remittances are currently sent through informal channels. For example, a Zimbabwean nurse in London pays money into a friendly businessman's offshore account, who then asks his cousin in Bulawayo to pay an equivalent amount, in Zimbabwe dollars, to the nurse's mother. Such dodges are popular because until recently, if you sent money through a formal bank, the government confiscated most of it, by means of a rigged exchange rate.

Mr Gono has made official channels more attractive by reducing the amount the government confiscates, and by cracking down on illegal foreign-exchange dealing. So some Zimbabweans may heed his call. But most won't, because that would mean giving the regime information about their finances, and no sane person would trust this regime with such information.

Since he took over the central bank in December, Mr Gono has endeared himself to Mr Mugabe, largely because of his success in curbing inflation (see article). Last month's official rate was “448.8%”, down from over 600% late last year. But the real economy remains in disarray. The white farmers who used to provide the largest chunk of Zimbabwe's exports have almost all been driven off their land. GDP has shrunk by one-third in five years.

Confidence cannot return unless private property rights are respected. There is no prospect of this with Mr Mugabe in charge. This month his land minister floated the idea of abolishing all freehold land tenure and replacing it with leases of up to 99 years. The government then back-pedalled a bit, though Mr Mugabe probably preferred the unadulterated plan. If all land belonged to the state, he could dole it out to his supporters and take it back if they proved disloyal.

Mr Mugabe sees property-owners as a threat. Many middle-class Zimbabweans (most of them black) have irritating ideas about democracy, and have the means to make themselves heard. They bankrolled the Movement for Democratic Change (MDC), an opposition party that would have won the last two national elections, had they not been rigged. Mr Mugabe feels safer when whites and white-collar blacks leave the country: then they cannot vote.

He pushes them out in various ways. Employing thugs to break their fingers is one. Confiscating private property is another. But he also uses more subtle techniques. For example, last month, his government ordered the country's private schools to reduce their fees or close. Armed police were sent to enforce the edict, so most schools complied. Given rapidly rising costs, this guarantees that standards will fall, which will prompt more middle-class parents to emigrate. One headmaster says that when he protested to the education ministry, he was told to raise extra cash by ploughing up playing fields and planting maize.

The state education and health systems, the proudest achievements of Mr Mugabe's early years in office, are imploding. Only four years ago, primary school enrolment was 95% for boys and 90% for girls. Last year it was 67% for boys and 63% for girls. Zimbabweans are so broke that they cannot afford state school fees of $4 a term. Infant mortality has doubled in a decade, and life expectancy has fallen from 60 in 1992 to a projected 35 next year.

The Mugabe miracle

As recently as 1997, Zimbabwe was twice as rich as the median sub-Saharan nation. Now it is crashing towards the norm. In keeping with this theme, Mr Mugabe is trying to replace the relatively sophisticated, pluralistic society that Zimbabwe once had with a stereotypical African patronage system. To enter university or to find a job as a teacher, it now helps enormously if you first join Mr Mugabe's youth militia.

Mr Mugabe wants a smaller, more dependent middle class. And he is content for the rest of the country to revert to subsistence farming. He claims that his policy of taking land from white farmers and giving it to blacks has been a success: that there will be a bumper harvest this year and so Zimbabwe will need no food aid. Actual crop-production statistics are now a state secret, so the picture is foggy, but a short drive through the countryside reveals vast swathes of barrenness. The World Food Programme estimates that 4.8m people—more than a third of the population—will need food aid this year.

Incognito, your correspondent spoke to some peasants in a ruling-party stronghold in Mashonaland, who said that if there was going to be a bumper harvest this year, they had not seen any signs of it. All agreed that life was growing swiftly harder, and most thought the government was to blame. But—and this is why Mr Mugabe prefers peasants to middle-class folk—they all said they would vote for the ruling party, ZANU-PF. Why? “Because we fear that if we turn against the government, we will be victimised,” said one.

A general election must be held by early next year. The regime is stockpiling imported maize. With donors barred from the country, it hopes to use its monopoly of the national staple to reward its supporters and starve the opposition. The media are shackled, the leader of the opposition is on trial for his life, and the judiciary has been so thoroughly nobbled that the MDC's lawsuits contesting the results of the last election won't be processed before the next election is held.

Where will it end? In English, for an international audience, Mr Mugabe occasionally hints that he wants to retire. But in Shona, his native tongue, he makes it clear that he does not. The man who was until recently tipped to succeed him, Emmerson Mnangagwa, has been swatted down: several of his associates have been arrested on corruption charges. Mr Mugabe does not want any of his lieutenants getting too big for their jackboots.

South Africa's president, Thabo Mbeki, told President George Bush last year that the Zimbabwean crisis would be solved by now. But he has made no serious effort to resolve it. At times, he has claimed that the MDC and ZANU-PF were in secret talks, though both parties denied it. He refuses to put any pressure on Mr Mugabe to respect the will of his own people, though he could. “South Africa could end the madness in a week, without a shot being fired,” fumes a black Zimbabwean businessman in Johannesburg, “simply by threatening to cut off the electricity and blockade the borders. But they won't.”

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Former Zimbabwean farmers

Zim's loss, Zam's gain

Jun 24th 2004 | LUSAKA
From The Economist print edition

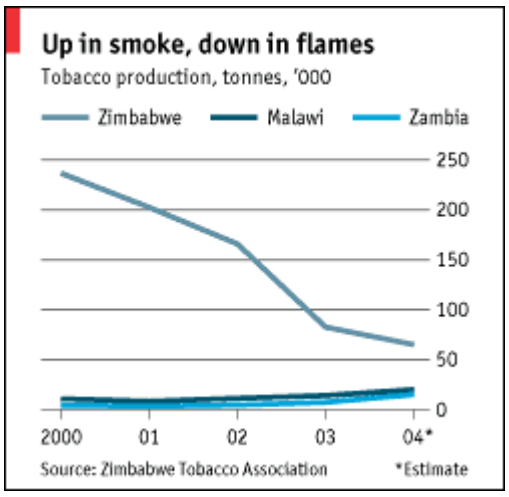
It's much nicer over the border in Zambia

Get article background

“THESE doors of opportunity have suddenly sprung open,” says Peter MacSporran, a white farmer who used to live in Zimbabwe. Well might he celebrate. Water fills his new dam; he ploughs rich fields which were bush and ant-hills a few months ago; he has built barns, curing sheds and roads, dug irrigation trenches, and set up huge American-made sprinklers. With an investment of $10m and 3,500 workers on his payroll, he is creating one of the largest tobacco farms in the world—from scratch. Besides tobacco, he grows maize, wheat, soya and seeds, and has 6,500 cattle. Three years after relations of President Robert Mugabe snatched his farm in Zimbabwe for nothing, Mr MacSporran is flourishing in Zambia.

Some 300 white Zimbabweans, welcomed by the government of President Levy Mwanawasa, now lease some 150 farms in Zambia. Tobacco firms and eager banks have coughed up. Zambia's farm minister, Mundia Sikatana, says “the sky's the limit” for Zambian production. This year's tobacco harvest of 15m kilos (33m lb) nearly hit the country's record; some experts think that in a few years that figure could quadruple. Other nearby countries that have welcomed white Zimbabweans have benefited too. Mozambique now grows enough tobacco to need a processing factory of its own, being built in the northern town of Tete. Meanwhile, Zimbabwe's output (see chart) has slumped.

Tobacco buyers drive much of the change. Universal Leaf, the world's largest tobacco merchant, is encouraging production in several southern African countries, so spreading the political and climatic risk. In Zambia, that American firm is investing $42m in 48 big farms and 1,200 smallholdings, creating—it says—24,000 jobs. A tobacco-processing factory in Lusaka, Zambia's capital, is to be built by 2007. Zambia's production may then overtake Zimbabwe's.



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Al-Qaeda

Setbacks for terror

Jun 24th 2004 | CAIRO
From The Economist print edition

In several Muslim countries, terrorists have been hit—and may hit back

Get article background

AFP

The Saudis screen al-Qaeda

IT HAS been a rough week for al-Qaeda. Police action in several countries has hit it—and its *jihadi* affiliates—hard. Algeria and Saudi Arabia scored the biggest triumphs, with security forces killing the leaders of both countries' most active insurgent groups and capturing several of their top lieutenants. In Bahrain and Morocco, police claimed to have rounded up two local *jihadi* cells. In Pakistan's Northwest Frontier Province, a missile fired from a helicopter killed a Pushtun tribal leader known to have succoured al-Qaeda fugitives. But if the *jihadis* are down, they are certainly not out. Website communiqués vow revenge. Security experts predict that al-Qaeda will soon strike back, if only to prove it is still punching.

Success was particularly sweet for the Saudis, whose hapless police had been shamed by a year-long sequence of gory and spectacular terrorist attacks, after several of which the perpetrators made clean getaways. Most recently, a group calling itself “al-Qaeda in the Arabian Peninsula” gloated at having shot dead one American working in the Saudi capital, Riyadh, and having kidnapped another in broad daylight. The snatch victim, Paul Johnson, an aircraft engineer, was later beheaded, with the now-familiar imagery of this gruesome end beamed proudly around the world on the internet.

The failure to stop this crime added to the embarrassment of last month, when Saudi police failed to catch three out of four men who went on a day-long rampage in the eastern city of Khobar that left 22 people dead. Yet within hours of Mr Johnson's death, police managed to stake out four of the kingdom's most wanted terrorists at a Riyadh petrol station. Sharpshooters killed them on sight, and a police search of the district netted a further dozen suspects. Among those killed was Abdel Aziz al-Muqrin, a hardened veteran of *jihad* in Afghanistan who had been al-Qaeda's local head since last year.

No one expects the kingdom's *jihadi* insurgency to stop with that. Even if most Saudis regard the appearance of terrorism in their midst with alarm and growing revulsion, a core of committed religious fanatics will pursue a campaign to “cleanse” the peninsula of infidels, teach America a lesson and overthrow the House of Saud. Islamist websites on the internet reflected mixed opinions. To some, Mr Muqrin is a martyr. One cyber-zealot describes the grimace on his face, in pictures issued by the Saudi authorities, as a beatific smile, a sign of holiness.

The initiative and higher morale has passed, for the moment, to the Saudi authorities. But their task remains difficult. Sixteen out of a list of 26 top suspects released by the authorities last summer remain at large. Mr Johnson's body has not yet been found, suggesting that he had been held by a different cell from the one eliminated in Riyadh. Al-Qaeda is said to have already named a new chief for Saudi Arabia, its third within a year.

The success scored by Algerian forces may have a more lasting effect. Whereas Saudi Arabia has been battling extremists for merely 13 months, with a total of around 100 people killed, Algeria has lost more than 100,000 lives in 12 years of unrest. The violence has dipped considerably since 1999, when thousands of Islamist guerrillas accepted an amnesty and came down from the hills. Two hold-out groups have continued to sow fear, despite their dwindling number of adherents. The largest, known as the Salafist Group for Preaching and Combat (or GSPC in its French acronym), is believed to have retained

some 500 fighters. Last year it pledged allegiance to al-Qaeda and earlier this month announced it was adopting a similar infidel-cleansing policy. This raised diplomats' fears of a return to the targeting of foreigners that had been seen in the mid-1990s.

Last week the Algerian army cornered a GSPC cell in a forest region near the city of Bejaia where a dozen soldiers had been slaughtered in an ambush two weeks earlier. Seven guerrillas were killed, four of them identified as senior leaders, including the group's commander, Nabil Sahraoui. Considering the huge country's rough terrain and the exhaustion of public sympathy for extremism, the group is unlikely to recover quickly. Editorial comment in Algeria's press, which is often critical of the military, was fulsome in praise. “This time the beast has been seriously affected and weakened,” said one respected newspaper. Algerians are too war-weary to expect an early end to their troubles, but many believe this could be the beginning of the end.

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Turkey and Israel

A strategic friendship cools

Jun 24th 2004 | ANKARA
From The Economist print edition

The two old allies are getting on each other's nerves. Why?

Get article background

WHEN Tayyip Erdogan, a former Islamist, swept to power alone in 2002 to become Turkey's prime minister, Israelis were worried that relations with their closest friend in the region might cool. True, Mr Erdogan had publicly disavowed his Islamist past and insisted he would still look to America, Europe and Israel for friendship. But the Israelis wanted proof.

They are not getting it. On the contrary, a year ago Mr Erdogan snubbed a request by Ariel Sharon, Israel's prime minister, to visit Turkey. Neither Mr Erdogan nor his foreign minister, Abdullah Gul, have been to Israel. Officials on both sides say the “special relationship” is secure. A pact signed in 1996 still lets Israeli fighter pilots train in Turkish airspace, to the irritation of many Arabs. Trade still booms.

But the bad blood is still being stirred. This week Silvan Shalom, Israel's foreign minister, said that Israel could not “restrain itself” for much longer in the face of Mr Erdogan's scratchy remarks, which were harming the very fabric of the two countries' relationship. Mr Erdogan has accused Israel of “state terrorism” against the Palestinians in the Gaza strip. Last month he asked an Israeli minister to explain the difference between “terrorists who kill Israeli civilians and Israel's killing of civilians too”. Similar bluntness earlier this month annoyed a group of Jewish Americans whom he met in the United States.

So why the change? Mr Erdogan's proclaimed distaste for Mr Sharon's policies is probably genuine. It is certainly shared by many millions of Turks who have been watching television pictures of Israeli tanks demolishing Palestinian houses. Besides, he has to appease conservatives in his ruling Justice and Development party. They are disgruntled by his failure, among other unIslamist things, to lift the ban on the wearing of headscarves by women in government offices and schools.

Some, however, say that the most compelling reason for Mr Erdogan's new tone of hostility is his belief that Israel has been encouraging Iraq's Kurds to form their own independent state that would not only become Israel's new ally in the region but might also rekindle separatism among Turkey's own restive Kurds. Such fears have grown since the *New Yorker* magazine said that Israeli agents now train Kurdish guerrillas in Iraq. Israel denies it.

Mr Erdogan knows he must tread warily. If he annoys Israel or the Jewish-American lobby too much, it will be harder for Congress to spike resolutions calling for recognition of the massacres of Armenians by the Ottoman Turks in the first world war as genocide.

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Polio

A virus revives

Jun 24th 2004
From The Economist print edition

Nigeria is exporting polio

YOU used to see them in slums everywhere: beggars with paralysed limbs, perhaps crawling, perhaps propelling themselves on hand-pedalled tricycles. As recently as 1988, polio was endemic to 125 countries and afflicted 350,000 people. Since then, a mass vaccination drive has nearly eradicated the virus. Last year, it lurked in only six countries and claimed only 784 victims. The UN's goal of wiping it out by 2005 seemed reachable. But a handful of zealots have put the clock back.

Imams in the northern Nigerian state of Kano argue that the polio vaccine is part of a western plot to make Muslims sterile. The state authorities suspended immunisation there last year, and although they promised to restart it in May, they have not. Polio has therefore spread around Nigeria with renewed vigour, and infected the neighbours. Ten previously polio-free African nations have recorded cases this year. As far away as Sudan, a new outbreak has been linked genetically to the strain of polio found in Nigeria.

Eliminating a foul disease is a matchless public good—remember smallpox? The last pockets of infection are always tough to mop up, but not impossible. In anarchic Somalia, vaccinators had to persuade two dozen semi-literate warlords to let them jab. They succeeded; Somalia is now polio-free. But so long as the virus finds sanctuary somewhere, nowhere is safe.

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Correction: Tunisia

Jun 24th 2004
From The Economist print edition

An inexplicable computer glitch caused two vital words to fall out of our special report last week on women in the Arab world. The phrase “non-Arab Turkey and Tunisia” became “non-Arab Tunisia”. Tunisia, of course, is an Arab state and a prominent member of the Arab League. Our apologies. The online version of this article has been corrected.

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The European Union summit

A difficult birth

Jun 24th 2004 | BRUSSELS
From The Economist print edition

European leaders have, at the last gasp, drawn up a new European Union constitution—but will it ever come into force?

HOW, six months after the Brussels breakdown, did European leaders resolve their differences on the new EU constitution? By three means: arm-twisting, obfuscation and opt-outs.

Arm-twisting worked on the main issue that caused the failure in December: the weighting of votes. Under heavy pressure, Poland and Spain accepted a new “double majority” voting system that dilutes their power. But a degree of obfuscation smoothes the change. The original plan was that a law would pass if it had the support of half the 25 EU countries, representing 60% of the population. The new deal raises the voting thresholds to 55% of countries, representing 65% of the population, with an added provision that a blocking minority must come from four or more countries. This makes it easier for Poland and Spain to block laws they do not like, but stops the big three doing it alone.

Britain's insistence on retaining a veto in many areas was the other big obstacle. Tony Blair won a clear-cut victory on tax. Provisions to harmonise corporate taxes by majority vote were struck out, a relief to countries such as Slovakia that rely on low taxes. Obfuscation dealt with foreign policy. The draft said that, if the new EU foreign minister made a proposal, the Union could decide whether to adopt it by majority vote. Now the foreign minister can make a proposal only if EU governments unanimously ask for it. Connoisseurs of baffling diplomatic compromises are referred to Article III-201(2), sub-section (b).

Mr Blair's other red lines were dealt with by “opt-outs”. Under the constitution the EU gets the right to harmonise aspects of criminal law by majority vote. But a new provision states that, if a country feels a European law threatens “fundamental aspects of its criminal justice system”, it may apply an emergency brake. Initially this delays the law's passage. If a new version cannot be agreed, objectors can opt out, allowing a smaller group of countries to press ahead. This tolerance of deeper integration by a small group was a sop to federalists. An even stronger emergency brake will apply to social security.

The biggest innovation is the Charter of Fundamental Rights, which protects everything from the “right to life” to the right to strike. Two years ago, the British were reluctant to accept that the charter should be in the constitution, because it was alien to British legal traditions and might be used to overturn

Thatcher-era labour-market reforms. But long before the latest summit, Britain had accepted its incorporation, with the full force of law. Instead, Mr Blair took comfort in a statement stressing that it would apply “to the member states only when they are implementing EU law”, as well as a reference to the need to interpret rights in accordance with national traditions and practices.

British lawyers had also prepared an exhaustive “explanation” of the rights, to show that they all exist in some other form either in EU law or in conventions that the EU has signed. The point was to underline that the charter creates no new rights. In an effort to nail this down, the British got a new clause inserted instructing the European Court of Justice (ECJ) to pay “due regard” to these explanations. In effect, the British wanted a provision that “all of the above is meaningless and will change nothing.” Have they succeeded? John Monks, general secretary of the European Trades Union Congress, complains that Britain has defanged the charter. He admits that trade unions had hoped to use the charter to attack the Thatcher labour laws, such as one barring secondary picketing, but says that is now impossible.

Even so, the charter's impact will be broad and unpredictable. Paul Craig, a law professor at Oxford, says that the key point is that there must be a European law which provides a “lock” for a legal challenge under the charter. If a plaintiff can show that a member state, or the EU itself, is violating the charter in the way it applies the law, then it is open to a challenge before the ECJ. Mr Craig thinks the ECJ will take many more cases involving “rights-based challenges” to European law. Despite the qualifications now added to the charter, these could stray into sensitive areas of domestic politics. For example, France's ban on the wearing of the Muslim veil in schools could be challenged by a Muslim child from another EU country, on the ground that the ban violates parents' rights to “teaching of their children in conformity with their religious, philosophical and pedagogical convictions”.

Will all this diplomatic ingenuity ultimately prove to be pointless? Ten countries (Belgium, Britain, the Czech Republic, Denmark, Ireland, Luxembourg, the Netherlands, Poland, Portugal and Spain) now plan to hold referendums on the constitution. Others, notably France, may yet follow suit. In Britain and Poland, the voters' mood currently points to a negative vote. That may be why the British and Poles want to put off any vote for a couple of years, hoping quietly that some other country says no first. The Dutch, who plan to vote by the end of the year, may oblige. Although they were one of the original six members, the Dutch are in a tetchy mood: they are the biggest per-head contributors to the EU, their economy has been in recession, France and Germany have torn up the stability pact that set fiscal limits for the euro area, and the EU is moving into immigration law, a highly sensitive topic.

If even one country votes no, it would be legally impossible for the constitution to come into force. But any naysayers may come under enormous pressure to vote again and say yes—or leave the EU altogether. If a larger group of countries reject the constitution, the document is probably dead. But in that case the EU might split into two groups: an integrationist core that accepted the constitution, and a more loosely aligned group that opts out of many political aspects of the EU. A constitution meant to unite a Union of 25 countries could thus end up dividing it.

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An EU constitutional primer

What it all means

Jun 24th 2004 | BRUSSELS
From The Economist print edition

The final legal text may not emerge before October, but here is a simplified guide

THE new EU constitution:

• Consolidates all European treaties into a **single document** labelled a constitution for the European Union.

• Incorporates a **Charter of Fundamental Rights** into EU law for the first time. This includes many social as well as political rights. But its application is limited to European law.

• Contains the first formal statement of the **primacy of EU law** over national law, a principle previously established by the jurisprudence of the European Court of Justice.

• Commits the EU to the progressive framing of a **common defence policy**.

• Commits the EU to creating common rules on **asylum and immigration** by majority vote. But individual states can still control the level of immigration.

• Extends **majority voting** to many other new, if mostly trivial, areas.

• Gives the EU formal **legal personality** for the first time, enabling it to sign international agreements.

• Retains **national vetoes** over direct taxation, foreign and defence policy and financing of the EU budget.

• Adopts a new double-majority **voting system**. Laws will be passed if 55% of countries representing 65% of the EU's population approve. This will make it easier for the EU to legislate.

• Creates some **important-sounding jobs**. There will be a president of the European Council and a foreign minister. The president will serve for up to five years, replacing today's six-monthly rotating presidency. The foreign minister will combine the roles of the external-affairs commissioner and the EU's high representative for foreign policy.

• Limits the size of the **European Commission**, but only from 2014. The principle that all member states must have a commissioner at all times is abandoned.

• Gives new powers to the **European Parliament** to amend laws, control the budget and approve the choice of president of the European Commission.

• Includes **subsidiarity** provisions under which, if a third of national parliaments object to an EU law, the commission must reconsider it.

•Creates an explicit **right for countries to leave** the EU.

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Jacques Chirac

Lonely at the top

Jun 24th 2004 | PARIS
From The Economist print edition

The French president contemplates his own isolation

Get article background

HE HAS been in French politics for so long that he seems a permanent fixture. Jacques Chirac was first elected to parliament in 1967, when Tony Blair was just 13. He has been France's president for almost ten years. Now, perhaps for the first time, comes the sense that he is isolated.

The latest knock came at the European summit. Mr Chirac did his best to sell the draft EU constitution as “good for France”, but the final text was not the integrationist document he had wanted. It let the British keep a veto over taxation and social security. With the text greeted on the mainland as a triumph for Mr Blair, Mr Chirac did not conceal his dismay. “We are obliged to recognise that the ambitions that we could have had have been reduced,” he said, “by the *non possumus* very clearly and strongly expressed, essentially by the United Kingdom.”

EPA

Jacques in a box

Worse, the efforts by Mr Chirac and Germany's Gerhard Schröder to install Guy Verhofstadt, Belgium's prime minister, as European Commission president fell flat (see article). This was a cruel reminder that, in an enlarged Europe of 25, the French and Germans can no longer steer matters alone. Mr Chirac must learn to build alliances with other countries, at a time when many new members remain suspicious of France, thanks to his high-handed behaviour over Iraq. Much of their hostility to France, says one Polish official, was caused by Mr Chirac's bullying.

Isolation in Europe is compounded at home. The French are fed up with Mr Chirac and his government. At two recent polls—regional elections in March and European ones in June—voters rejected his ruling Union for a Popular Movement, and swung left. Some 70% have no confidence in Jean-Pierre Raffarin, his prime minister. French tradition makes prime ministers the scapegoats in hard times, with the office of president rising above tawdry matters. Yet popular disaffection is increasingly directed at the president himself. Mr Chirac's personal approval rating has sunk from 50% last August to just 35% today, according to TNS Sofres, a pollster.

Even within his party, Mr Chirac's grip looks shaky. Founded to keep him in power, the UMP is in disarray. Last week, at the first round of a by-election in Paris, the official UMP candidate was trounced by a centre-right alternative, Bernard Debré, who talks of mounting a similar campaign for the Paris town hall. Several of Mr Chirac's political friends in France's overseas territories have also been evicted. Next month he loses his protégé, Alain Juppé, the UMP boss, who was convicted of political corruption in January.

Six months ago, *la chiraquie*—the president's circle—was bent on finding a loyal successor to Mr Juppé, and, above all, on keeping out Nicolas Sarkozy, the ambitious finance minister. Today, fretful for their own survival, former loyalists on the UMP backbenches have begun to desert the president. Roselyne Bachelot, Mr Chirac's spokesman for the 2002 presidential elections, says the party needs Mr Sarkozy. Alain Madelin, from the pro-market end, has swung behind him. This week Mr Chirac said that he was ready to acquiesce in Mr Sarkozy's taking over the UMP.

Where does this leave Mr Chirac? He faces no more elections until 2007. But manoeuvring for his succession is under way. To restore his authority, he may replace Mr Raffarin, perhaps in the autumn, after a health-reform bill is passed. Given his distrust of Mr Sarkozy, Mr Chirac is unlikely to offer him the job. Instead, he may turn to Dominique de Villepin, former foreign minister. Since leaving the Quai d'Orsay to become interior minister, he has roughened his edges in the company of policemen and firemen. Aristocratic and urbane, Mr de Villepin lacks both a common touch and a popular mandate: he holds no elected office. Faced with the unpalatable rise of Mr Sarkozy, however, Mr Chirac may feel he has no alternative.

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Lithuanian politics

Elites, gherkins and sugar-beets

Jun 24th 2004 | VILNIUS
From The Economist print edition

A country under a populist backlash

Get article background

THE impeachment of President Rolandas Paksas, ousted in April after close associates were caught peddling access and influence to businessmen and criminals, has sent Lithuanian politics wobbling in odd directions. Mr Paksas is a populist who won the loyalty of rural voters—"sugar-beets", as Lithuanians call them—by promising to stand up against elites in the cities and thieves in the government. The sugar-beets, angry at his ousting, are in search of new champions. In the European elections, they shunned established parties and rallied round a new populist vehicle, the Labour Party, led by Viktor Uspaskich, a Russian-born businessman-turned-politician known as "Mr Gherkin" after one of his product lines. Now the sugar-beets have another chance to speak, when voters choose a new president, in a run-off election on June 27th. A general election follows later in the year.

The front-runner for the presidency is Valdas Adamkus, president from 1998 until his defeat last year at the hands of Mr Paksas. But talk of a landslide for Mr Adamkus, a centre-right figure with no party affiliation, has subsided. Instead support is rising for his centre-left rival, Kazimira Prunskiene, runner-up in a first round of voting on June 12th, after an endorsement from Mr Paksas. The mood was unsettled further on June 22nd, when police raided the headquarters of political parties supporting Mr Adamkus. One newspaper called the raids an act of "political revenge" by admirers of Mr Paksas.

Mr Adamkus says he represents the future of Lithuania, and Mrs Prunskiene the past. The implication is that he stands for freedom, growth, the European Union and NATO (both of which it has just joined); and Mrs Prunskiene stands for a drift back to socialist, even Soviet, stagnation. Charges of being "soft on Moscow" have dogged Mrs Prunskiene since 1990-91, when she was prime minister during Lithuania's independence struggle. Nationalists said that she was too ready to compromise with the country's Soviet masters.

But at 77, Mr Adamkus is an unlikely spokesman for the future. And many voters are nostalgic for the past that he rejects. Lithuania is the second-poorest country in the EU after Latvia. Opinion polls suggest that most people, especially in rural areas, think they were better off in Soviet times. Some are now turning to Mr Uspaskich—and some to Mrs Prunskiene. A strong vote for Mrs Prunskiene would be worrying, even though the presidency is largely ceremonial. It would suggest that the general election in October could produce a populist coalition government led by Mr Uspaskich's Labour Party, with support from Mr Paksas's Liberal Democrats, and from Mrs Prunskiene's Farmers and New Democracy Union. Critics say that such a government would be both anti-reform and vulnerable to Russian influence.

Mr Uspaskich's strengths include his wealth, a common touch and a gift for telling dissatisfied voters what they want to hear. He promises to raise wages, pensions and farm subsidies. Lithuania, he says, "is going the wrong way, as unbridled capitalism and the shadow economy prevail." The truth is more encouraging. The economy, though bridled by the meddling and cronyism of politicians, is one of the fastest-growing in Europe. Unemployment has been falling. The question is whether Mr Uspaskich's opponents can get that message across before October, in terms that even sugar-beets can grasp.

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The future of Kosovo

Hope flares in the Aegean

Jun 24th 2004 | HALKI, GREECE
From The Economist print edition

Talks continue between Kosovo's Serbs and Albanians

KOSOVO has a new supremo. Soren Jessen-Petersen, a Danish diplomat, is to head the UN mission that runs the province. Its previous boss, Harri Holkeri, resigned in the wake of last March's violence, which saw almost 4,000 Serbs driven from their homes by angry Albanian mobs. One priority must be to get Serbs and Albanians talking again: since March Serbs have boycotted Kosovo's institutions, including the government. Talks between Kosovo, with its big Albanian majority, and the Serbian government on "doable" issues have not resumed.

Yet, perhaps surprisingly, communication between Serbs and Albanians is far from broken. Leading figures from both sides have met eight times this year, albeit outside Kosovo. Last week top advisers to Kosovo's Albanian prime minister and president met their Serb counterparts, among them Aleksandar Simic, one of the authors of a plan for Kosovo put forward by Serbia's prime minister, Vojislav Kostunica. The meeting, arranged by Eliamep, Greece's leading foreign-policy institute, took place on the Greek island of Halki.

As so often, the real business was done over wine and food. Alush Gashi, an adviser to Kosovo's president, Ibrahim Rugova, told Oliver Ivanovic, a Kosovo Serb leader, that the Albanians wanted to negotiate with Kosovo's Serbs, but that the Serbs had to return to the province's assembly if this was to happen. Flipping between Serbian, Albanian and English, politicians sought to break the deadlock.

That Serbian and Albanian policymakers are meeting can only be a good thing. But some foreign diplomats worry that the utility of these gatherings is diminishing. Getting to know each other, and eating some fine meals, are all well and good; but the time is approaching for real work. Dimitri Triantaphyllou, an adviser at the Greek foreign ministry, suggests that it would be a good moment for institutes such as Eliamep to organise a co-ordinated series of structured, low-profile meetings at which Serbs and Albanians should be asked to work out what they can agree upon, and how to put that into practice. As he puts it, "the time is ripe, because we have no time to lose."

Too right. This weekend Serbia votes in the final round of its presidential election. If Tomislav Nikolic, an extreme-nationalist candidate, wins, he may force other Serbian politicians to be more hawkish on Kosovo. Opinion polls suggest that he will not, but they have been wrong before. In October Kosovo goes to the polls. Kosovo Albanians are running out of patience with waiting for the independence that their leaders have promised—so they could back extremists of their own. The window in which to resolve Kosovo's status peacefully may soon close.

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War in the north Caucasus

Not so small any more

Jun 24th 2004 | MOSCOW
From The Economist print edition

Could the war in Chechnya be turning into a war outside it?

Get article background

WHILE the Russian army practised in the east, showing its ability to respond to threats it no longer faces, Chechen rebels in the south demonstrated its inability to deal with threats that are its daily fare. In the biggest attack outside Chechnya since the 1999 incursion into Dagestan, which provoked Russia's second war in Chechnya, over 200 men attacked targets in Ingushetia, among them the interior ministry in Nazran. The raid left almost 100 dead, among them senior Ingush officials and a UN worker. The attacks came a few weeks after a bomb in Grozny had killed Chechnya's Kremlin-imposed president, Akhmad Kadyrov.

As usual, Russia blamed Aslan Maskhadov, Chechen rebel leader and one-time elected president. His aide, Akhmed Zakayev, in exile in London, denied it; but Mr Maskhadov had told Radio Free Europe/Radio Liberty that the rebels were changing tactics from “acts of sabotage” to “launching big attacks”. The day before the attack, Mr Zakayev confirmed to *Kommersant*, a newspaper, that such a decision had been adopted by field commanders on June 14th—among them Shamil Basayev, who had led the Dagestan raid. Russia's interior minister, Boris Gryzlov, said that the attack was “a consequence of the work of the law-enforcement agencies”, a last shout by rebels of whom many “have already been eliminated”. But the scale of the attacks suggests the opposite.

Ingushetia is where many Chechens fled from the war. Tens of thousands were put up in camps run by foreign donors. Last year, to support its claim that Chechnya was normalising, the government began closing the camps and sending refugees “home”, often under threat of violence or prosecution. According to a report from Human Rights Watch, “human-rights abuses which previously occurred almost exclusively in Chechnya are increasingly spreading across the border”, among them killings and kidnappings by Russian and Chechen security forces.

All this, says Thomas de Waal, of the Institute for War and Peace Reporting in London, could have led to “home-grown seed-beds of militancy in Ingushetia, perhaps just a few miles down the road from Nazran”. A hint came from reports that some raiders spoke Ingush, not Chechen, and that the man the authorities claim led the raid is an Ingush. That the attackers seemed to come from several directions, including from South Ossetia, shows that, even if the usual escape route to Georgia is closing (see article), the guerrillas can still move with ease inside Russia.

This week Russia's upper house of parliament was due to approve a law giving operational control of the army to the defence minister, leaving the generals in charge of strategy. This could help President Vladimir Putin's attempts to reform the army, and might be a step towards reducing the corruption that helps keep the Chechnya conflict going. But he has now sent more troops to Ingushetia as well.

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Chechnya and Georgia

Intrigue at 10,000 feet

Jun 24th 2004 | OMALO
From The Economist print edition

A complex web of differing tensions, strung along a difficult border

A SWEDE, a Bulgarian and an Irishman meet in a mountain village guarded by Georgians wearing American uniforms. What sounds like the start of a joke is reality in Omalo, on Georgia's frontier with Russia, where eagles usually outnumber foreign visitors. The reason lies across the ridge above Omalo: Chechnya. Ever since 1999, when President Vladimir Putin launched a new Russian attempt to regain control of Chechnya from rebels, they have used these mountains to sneak to camps in Georgia's Pankisi valley. With the melting snow, that traffic may start again.

Hence the 150-strong multinational group sent by the Organisation for Security and Co-operation in Europe (OSCE) to monitor the passes. “It is a third force than can say for sure who is crossing or not,” says Irakli Aladashvili, a military analyst. Two years ago, the Russians threatened an assault to stop the rebels. Tension rose when Russian aircraft bombed the Pankisi gorge. That woke Georgia's then-president, Edward Shevardnadze, to the threat the rebels posed to his country. He tightened control over the Pankisi valley, helped by a two-year American training programme for the Georgian army that ended in April.

The OSCE mission has helped too. But it has plunged the organisation into a web of intrigue. For the Russians, whose side of the frontier bristles with troops, minefields and air patrols, the OSCE provides useful intelligence: any sighting of Chechens is reported to OSCE headquarters in Vienna within hours. There are also Russian officers among the monitors. The Georgians have more reason to welcome the OSCE: they see it as protection against not only Chechen, but also Russian incursions.

Georgia's new president, Mikhail Saakashvili, is working hard to repair relations with Moscow. He is trying to build a good relationship with Mr Putin. He says he will admit genuine Chechen refugees, but “not the men with guns”. Under agreements signed this spring, Russian and Georgian border guards are to co-ordinate their patrols. Georgians hope that this might lead to Russia's easing its visa requirements and reducing its influence on Georgia's own separatist statelets, South Ossetia and Abkhazia.

Yet—as this week's incursion into Ingushetia showed—Chechen rebels are an elusive force, whether in towns, forests or mountains. “These are hard men”, says one OSCE monitor, “and I realise they can avoid us.” Political intrigue along this border is far from exhausted. Recently fresh complaints about trafficking into a conflict zone emerged. Only this time, it was the other way around: the Georgians were accusing the Russians of sending reinforcements to their separatists in South Ossetia.

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Age discrimination

Hands up those who want to go back to work

Jun 24th 2004
From The Economist print edition

The government and employers are rowing about new laws on age discrimination

IN OCTOBER 2000, the government signed up to an historic European directive to outlaw age discrimination at work. The effects of this ban on employers are far-reaching, so ministers negotiated a deadline of six years before it comes into effect. Later it promised to complete the new regulations with two years to spare.

This unexacting timetable is slipping. Neil Bentley, head of employee relations at the Confederation of British Industry (CBI) now expects the detailed provisions next year. This will give businesses little more than a year to prepare for the implementation in October 2006—less than they need for such a big shake-up in employment practices, he says.

The delay stems from a wrangle between government and business which has sparked a fierce dispute within government. The new regulations will have a big effect on recruitment, retention and retirement. It will become illegal for businesses to hire, promote or demote people on grounds of age. But the main point at issue is what to do about the third employment practice: retirement.

At present, employers can set a mandatory retirement age in their employment contracts. In the private sector, it is usually between 60 and 65. In principle, such a compulsory age is discriminatory, but the European directive allows countries to set a national retirement age. The CBI says that this should be 65, so that employers retain the right to enforce retirement at what they regard as a realistic age.

However, ministers want to go much further. Patricia Hewitt, in charge of the Department of Trade and Industry, which is drafting the new rules, backs 70. Andrew Smith at the Department for Work and Pensions would like to sweep away the whole idea of a mandatory retirement age.

The strategic argument in favour of abolition is a strong one. Like other countries, Britain's population is ageing rapidly. There have been remarkable improvements in life expectancy at 65, which rose in the case of men, for example, by almost three years in the 1980s and 1990s.

But if people live longer, they draw their state pensions—which will converge for men and women at 65 in 2020—for longer, which increases the tax burden on the working population. As the baby-boomers hit retirement age, the fiscal strain will grow. More older people working and paying tax will help offset the effect of population ageing; and extending working lives will also make it easier to raise the state pension age in future.

Ministers are seeking to use the age-discrimination legislation to send out a clear signal about the need to work longer. Alan Pickering, partner at Watson Wyatt, an actuarial consultancy, says that the British government is trying to “torpedo the early retirement culture”. He adds that businesses should benefit since this will lower the tax burden.

However, employers are worried about the practical consequences of the new rules. At present, employers can get rid of older workers once they reach the mandatory retirement age without fear of legal redress. They worry that, once the new rules are in place, they will either be stuck with costly, unproductive workers (see article) or face a flood of lawsuits.

In principle, employers should be able to win such cases provided that they can justify the dismissal on grounds of competence. Mr Bentley says that the necessary performance-management systems will be expensive for smaller companies to introduce. Philip Taylor, who researches age and employment issues at Cambridge University, says: “Employers are right to be concerned because these systems are not very

sophisticated so it may be hard to defend decisions based on them."

Both sides in the debate cite the experience of America, which banned age discrimination in 1967 and abolished compulsory retirement for most workers in 1986. Employers point out that companies face extra costs from age-discrimination suits—the CBI reckons that following the American model would cost employers at least £24m ($44m) a year—and constraints on their managerial freedom because of the threat of legal action. But American employers have learnt to get along with the legislation, and it does seem to have raised the employment rates of older workers. That may embolden British ministers when they finally announce their decision this autumn.

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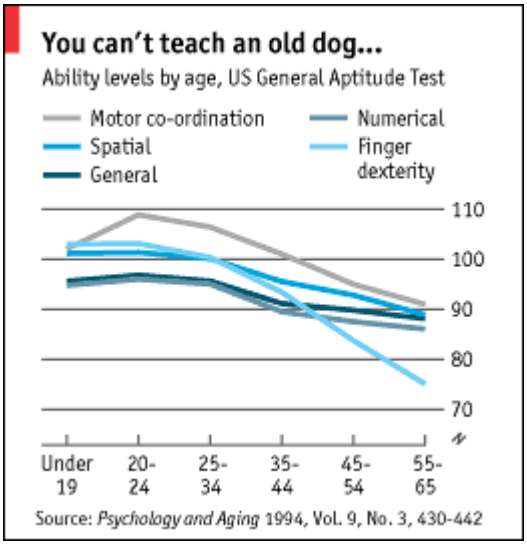
Age and productivity

Over 30 and over the hill

Jun 24th 2004
From The Economist print edition

While productivity tends to fall with age, pay tends to rise



PAY and productivity, it is generally assumed, should be related. But the relationship seems to weaken as people get older.

Mental ability declines with age. That's the same for the brainy and the dim—and not just for humans: it's measurable even in fruit flies. But minds that keep lively will suffer less than the lazy. In general, the more education you have, the more productive your old age will be.

Some abilities decline faster than others. According to most studies*, people's numerical and reasoning abilities are at their best in their 20s and early 30s. Other abilities—those that depend on knowledge, such as verbal abilities—may improve with age. One study, carried out in Seattle, suggests that verbal fluency peaks at 53, on average.

Measuring this sort of thing precisely is riddled with statistical pitfalls: as a cohort ages, for example, the frail, with low productivity, drop out. The survivors tend to be the brightest and toughest. That puts average scores up. On the other hand, improved education in past decades probably biases test scores against people too old to have benefited from it.

For most workers, decreased abilities will lead to lower productivity; only a minority will find know-how, knowledge and the ability to prattle convincingly outweighs their failing powers. And even for these, returns diminish: experience only counts for so much. This tilt is becoming steeper: technological change puts a premium on adaptability, and a discount on experience. Even those employees who remain highly productive will be likely to shine only in a narrow field.

Academics notice this. It's less clear that employers do. Studies of supervisors' ratings show no clear correlation between age and perceived productivity. When other employees' views are taken into account, though, the picture changes: these ratings suggest that workers in their 30s are the most productive and hardworking, with scores falling thereafter.

That's backed up by studies of work samples, which find lower productivity among the oldest employees. A study for America's Department of Labour showed job performance peaking at 35, and then declining. It varied by industry: the fall was slow in footwear, faster in furniture.

Brainier occupations are harder to measure, but the picture's the same. Academics seem to publish less as they age. Painters, musicians and writers show the same tendency. Their output, measured by both quality and price, peaks in their 30s and 40s. The only exception is female writers, who are most productive in their 50s.

So what does this mean for wages? Earnings in most advanced industrialised countries tend to peak for workers at some point in their 50s. But productivity is already falling by then. “Younger workers are underpaid and older workers overpaid relative to their productivity,” says Vegard Skirbekk, a Norwegian demographer based in Germany.

Why? One explanation is that though new employees may be more productive on average, their individual abilities are uncertain: hiring someone older is a safer bet. Treating older employees well may

increase loyalty among younger workers. That would make sense in bits of the labour market where precise measurement of output is hard, and workers are unlikely to shift to other employers. But, as the number of older workers rises, this comfortable arrangement (for the old, at least) is likely to break down.

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* "Age and individual productivity: a literature survey", Vegard Skirbekk, Max Planck Institute for Demographic Research, 2003

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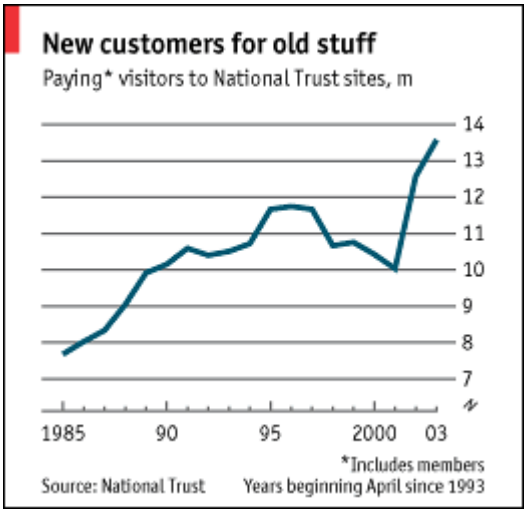
Flogging heritage

Lonely as a crowd

Jun 24th 2004
From The Economist print edition

The National Trust gets demotic and wins new friends



SINCE it took power in 1997, the Labour government has been as uncomfortable with heritage as are the out-of-work actors who squeeze themselves into corsets at the weekend and wander around Hampton Court greeting tourists. The word, which smacks of the undeserving rich and their unearned inheritances, has been largely dropped in favour of “the historical environment”, a phrase that suggests that Britain's many houses and castles fell like acorns from the sky.

Given this, the recent success of the National Trust, once caricatured as a provider of outdoor relief for aristocrats, must be rather galling. Visits to Trust properties have risen sharply in the past few years (see chart). This reflects an increase in the number of people paying around £30 ($55) a year for membership, since members make up the bulk of visitors. The number of members has risen by 20% over the same period to 3.3m. Why?

Part of the explanation lies in dull demography. The age group 56-65 makes up 12% of the Trust's visitors, compared with 10% nationally, so an ageing population favours the Trust. A recovery in the domestic tourist market has also helped. The evidence for this is mostly anecdotal, though Mintel, a company that analyses consumer spending, estimates that Britons spent around £18.1 billion on holidays in their homeland.

The Trust has also been fighting harder for its share of the market. It became big through coming to gentlemanly arrangements with the owners of big houses who could not afford to live in them. In exchange for public access and endowments, the owners got to stay put and understood that the Trust would not change the curtains or rearrange the pictures. But recently it has shaken things up a bit. Trust properties are now used as venues for concerts and recreations of historical events. And more are being pitched as heritage experiences, rather than just old houses.

The change in approach was seen this week when the house that poet William Wordsworth grew up in was reopened by the National Trust after a refit. The romantic poet's bedroom is on show, complete with toys and clutter. A manservant, maid and nursemaid wander around the house and the 18th-century kitchen provides food. Visitors are even encouraged to touch things and use the furniture.

This may upset traditionalists and those who worry that they are being served up a pastiche of the past. But Simon Jenkins, author of a book on England's 1,000 best houses, points out that the first aristocrats who opened their doors to the prying public were masters at giving the customers what they wanted. The Duke of Bedford was probably the most accomplished of them: he charged people to watch him eat his lunch.

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Legal aid

The rising cost of justice

Jun 24th 2004
From The Economist print edition

And, for once, it's not the lawyers' fault

DISLIKE lawyers? Here's grist to the mill. Of every five pounds gobbled up by the legal profession in England and Wales, one comes directly from the taxpayer. Preliminary figures from the Department for Constitutional Affairs suggest that the cost of the legal-aid system in England and Wales has risen by 25% in the past three years, to over £2 billion ($3.6 billion). That is more than any other country in Europe. If the criminal courts are excluded, it is more even than America.

For any regime trying to control public spending, this would be a problem; and the British government is trying to make it a problem for the legal profession. Cost-cutting efforts now under way range from a fundamental review of legal aid, to the noisy pursuit of dishonest immigration solicitors, to attempts to rein in spending on complex criminal cases (which alone cost £329m last year). The latter measure has been rather too successful: barristers refused to sign up to the new system, and trials were delayed.

How has a traditionally scruffy area of law become so high-maintenance? It is tempting to point the finger at money-grubbing barristers and sloppy solicitors. But the real causes of spiralling costs are located outside the courtroom.

The first reason has to do with the growing supply of new law. It is the fate of the legal system, as Stephen Irwin, chairman of the Bar Council, puts it, “to be on the receiving end of clever ideas from elsewhere.” And there are a lot of fresh ideas about at the moment. The incorporation of European human rights law has made things more complex; so have well-meaning politicians. Innovations like the 2002 Proceeds of Crime Act, which enables prosecutors to pursue ill-gotten gains, have lengthened many trials, often to little effect. Mr Irwin was involved in one case where three hours of court time were spent pursuing £30.

The other thing on the increase is the volume of evidence, especially in serious criminal cases. Nick Wood, a practising barrister, says that the spread of technology has created exciting new ways of establishing guilt. Where fingerprints and eyewitnesses used to suffice, prosecutors now present reams of mobile-phone records, CCTV tapes and DNA evidence, all patiently explained by expert witnesses. Such evidence is especially useful for identifying accomplices, says Mr Wood: “so, instead of there being two defendants in a case, you might now have five.”

All this provides more clients for defence lawyers to represent, and more claims to rebut. And, since the threat of prison automatically opens the legal-aid coffers, it means a greater drain on public funds. Call it the price of justice.

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About sponsorship

Glastonbury Festival

Papers, please

Jun 24th 2004
From The Economist print edition

Whatever happened to the counterculture?

IF YOU are planning to go to Glastonbury, Britain's biggest pop festival, this weekend, you had better go prepared. You will need your unique, personalised ticket and a bank statement, driver's licence or debit card to prove your identity. Anyone with no tickets and hippy ideas about free love and free music will have a 12-foot-tall, four-mile-long perimeter fence to scale. There will also be spot checks for cars without tickets within a 15-mile radius and patrolling guards in Land Rovers. With this kind of security Michael Eavis, who runs the event, might consider offering to host the next G8 summit.

How different from 1970, when the first Glastonbury Fayre attracted about 1,500 curious revellers to a single field for a laid-back weekend of folk and blues. Admission was £1 ($2.40), and that included free milk. The next year entry was free. Today's tickets cost ten times as much in real terms and must be ordered online or by phone. The emphasis is now on security, safety and making sure that the 115,000 people who have paid are the only ones allowed in.

So does all this dilute the freewheeling spirit that made the festival so popular in the first place? Official advice is to bring those twin symbols of modern capitalism—a credit card and a mobile phone. The high ticket prices seem likely to prevent some of the more colourful elements from turning up. Reflecting on the kind of people who attend the modern event, one Glastonbury regular said: “The ticket price and the method of buying, plus the huge fence, creates a Glastonbury that reflects the rich/poor divide in the rest of society, rather than being the anti-establishment, free, fun, inclusive summer outing it once was.” There is a family-oriented camping ground for parents with young children, sensible advice on noise levels and reminders not to drink to excess. Even the ablutions are upwardly mobile: “The showers seem to get busier and more high-tech every year. You don't see many soap-dodgers or smelly teenagers. And hardly any Scousers.”

To be fair to Mr Eavis, the local council, which gives him his entertainment licence, demands the security measures. The festival was cancelled on public-safety grounds in 2001 after an estimated 200,000 people had turned up the year before—nearly 100,000 more than the council had allowed. The safety-conscious, child-friendly festival has become a fixture in polite society—more middle class than Middle Earth.

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About sponsorship

Creationism

Creating in a void

Jun 24th 2004
From The Economist print edition

Wealthy creationists are taking over failing state schools

Get article background

ON ONE side is Britain's best-known atheist polemicist, in unlikely alliance with his media-savvy local bishop. On the other is a wealthy Christian businessman who does not believe in evolution; he's defended by the government. Their fight is prompted by “city academies”. These new schools receive extra cash from government, typically a lump sum of £20m, with individuals, businesses and charities adding a further £2m and running the school. It sounds fine—but what if the sponsors are bonkers?

In the north-east of England, a charitable foundation backed by one of Britain's richest men, the fervently religious Sir Peter Vardy, is sponsoring a bunch of new schools. So far, these have done well: the education inspectorate gives them glowing reports; so do parents, who like the discipline, standards and pastoral care.

That has muffled secularists' fears. Revealingly, both existing Vardy schools exclude Harry Potter books from their libraries: that suggests a dash of bigotry. So does the teaching of evolution as only a theory, alongside the Bible's account of creation.

Now proposals to turn a school in Doncaster into a Vardy-backed academy have sparked renewed protest. Two hundred people demonstrated there last weekend. And in the *Sunday Times*, Richard Dawkins, a famously anti-clerical Oxford science professor, joined forces with Richard Harries, the bishop of Oxford, calling the Vardy schools' creationism “bad science”, “lousy theology” and “blasphemy”.

But behind this entertaining ding-dong is an argument about the whole of government's reform of secondary education. This wants to make schools more varied, better-run (including by outsiders), and free from the local state education bureaucracies—but all without disadvantaging the dim, the poor and the disturbed.

The school concerned, Northcliffe, has plenty of such problems. Its intake is “challenging”, in education-speak. Fully 37% have “special needs”—typically behavioural and emotional problems. “Some have very difficult home backgrounds,” says Tracy Morton, a parent and campaigner against the academy. “Their parents don't even register them for school—they just send them along on the first day of term.”

Ms Morton is less worried about Christian fundamentalism than about the academy's approach to selection and discipline, and in particular how children from chaotic homes will fare under the new regime. The showpiece Vardy school, Emmanuel College in Gateshead, recruits from a large urban area. That means it can attract ambitious, diligent pupils from good homes. A local comprehensive like Northcliffe is very different.

The academy's backers insist that the new school will be non-selective, with no discrimination against those with special needs. They also point to King's Academy in Middlesborough, the second Vardy school, which has a diverse intake including a quarter with special needs, and maintains tough discipline without mass expulsions.

It is hard to imagine a more crucial test of the government's education policy. If a strongly-led new city academy can transform a really difficult school—and not just by shunting the worst children elsewhere—it hugely strengthens the argument for more diverse kinds of schools with outside management. But if not, the suspicion will grow that city academies' success is really down to loads more cash and hand-picked pupils.

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About sponsorship

Split-capital trusts

Cancerous

Jun 24th 2004
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The Financial Services Authority takes flak over a savings scandal

Get article background

JOHN TINER and Callum McCarthy, the bosses of the Financial Services Authority (FSA), Britain's financial watchdog, fielded questions from MPs on the Treasury Select Committee on June 23rd about restoring confidence in the long-term savings industry. Stop it pinching savers' money, would have been the obvious answer—and nowhere more applicable than in the split-capital trusts scandal, which has tarnished further the reputation of an industry which already had little shine. John McFall, the committee's chairman, called the scandal “a tumour on the body politic of financial services”. Nailing the firms responsible, which include some of the most prominent in the financial firmament, is, however, proving difficult.

As with other financial products that have been foisted on the unwary, the problem with split caps, as they are known, is that the people selling them made pots of money from the ignorance of the buyers. Last year, the select committee described them as little better than “sophisticated snake-oil salesmen”.

Unlike unit trusts, investment trusts are structured as companies that invest in the shares of other companies. Split caps differ in that they have various types of shareholder. In recent years the shareholder pie has been sliced into a dizzying array of shapes. Most complaints received by the FSA have been about “zero-dividend preference shares”, buyers of which are paid only a fixed sum at maturity.

Assuming there is the money to pay them, that is. Many split caps didn't have enough, because their fortunes depended on the stockmarket, which had fallen. The effects were amplified because in recent years split caps had not only often invested in each other, but multiplied their bets with money borrowed from banks. Some 20 split-capital trusts have gone bust.

The FSA thinks that investors lost about £1 billion or so from investing in split caps, though some of these investors are of the institutional sort, who should be able to look after themselves, and some money would have been lost anyway because the overall stockmarket had fallen. That leaves £350m that the FSA says those involved in selling split caps should pay in compensation to the 50,000 or so small investors who have lost out.

The companies that peddled split caps have had different ideas. The 21 targeted by the watchdog offered £120m. The FSA thought the offer derisory, and broke off discussions in May. It is instead throwing the rulebook at the alleged miscreants, though hoping that this will force them to settle. This month it has started to take the companies to the Regulatory Decisions Committee, a sort of court to the FSA's policeman, on the charge of market abuse.

The FSA oozes confidence about the evidence it has amassed, boasting of the hundreds of files and thousands of hours of taped conversation studied by its 60-strong investigative team. It is not, however, allowed to name names or publish evidence, unlike, say, Eliot Spitzer, New York's energetic attorney-general, who happily—and effectively—does both.

Why not? The law requires the FSA to assume that those it investigates are innocent until proven otherwise. An admirable sentiment, but given the record of the financial-services industry over the years, many must wonder whether the best way of restoring trust in the financial industry might be to assume the opposite.

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Textiles

Cloth of gold

Jun 24th 2004 | BRADFORD AND HUDDERSFIELD
From The Economist print edition

Lively parts of a near-dead industry

AFTER three decades of gloom, this week brought a rare good news story for the British textile industry: Nike, a big sports-shoe maker, ordered 9,500 metres of Harris Tweed for a new range of women's trainers. Aside from the odd idea of a tweed trainer, the story is not as unusual as it sounds: although the British textile industry as a whole continues to shrink, at the top of the market a lot of small and medium-sized companies are making a good living and big reputations.

The British textile business, centred in West Yorkshire, took a wrong turn in the 1960s. Under pressure from Asian imports, the old family firms imported cheap labour from Pakistan to try and compete on price. The Italians, meanwhile, invested in better design and technology. The British also failed to spot that the traditional Yorkshire virtue in a suit—longevity—was losing out to the tawdry appeal of style and designer labels. As the pressure from Asia tightened, Italy's textiles flourished while Yorkshire's mills closed down. But now, as smarter companies have moved upmarket, things are changing.

Firas Chamsi-Pasha arrived in Huddersfield from Syria in 1981 when Hield Brothers, an old family-run weaving business for whom he was an agent, ran into trouble. He bought the company and cut its middle-market cloth production to concentrate on the top of the market, and added shirts, ties, socks and shoes to create a complete Hield range of pricey menswear, retailing them in London and ten American cities. In 1993, he bought another Yorkshire company, Moxon. Its suits sell for up to $26,000 (£14,300) in America. Mr Chamsi-Pasha opens a finely-crafted box you might expect to contain diamond jewellery to reveal instead a pair of socks. They cost £275. “You can only wear them ten times,” he says.

Adrian Berry, managing director of Clissold, has transformed the £250,000-a-year turnover, two-person business he and some friends bought in 1976 into a firm turning over £10m a year. It makes suits selling for up to £2,000.

Clissold is a “loomless manufacturer”, only designing its suits: the cloth-making, cutting and stitching is done by others. This work, however is out-sourced not to Asia, but to local firms. Business, he says, is pretty good. Demand for suits is rising, driven by an upturn in the Japanese economy, an end to the fashion for casual clothes at the office and, he thinks, a trend amongst young people towards dressing more formally when socialising.

Why are British companies doing well at the top end of the market? Mr Chamsi-Pasha claims that good local water, needed for cleaning and processing wool, is most of the explanation. Another is that enough remains of the skills required for turning the long thin fibres from the best quality wool into the worsted cloth used in the finest suits which is the hallmark of West Yorkshire textiles.

Some of Yorkshire's textile firms are even finding demand is outstripping supply. “I reckon that there is a shortage of about 20% of weaving capacity,” says Edward Stanners, chairman of Textiles Forward, an industry research and training body. If the industry's decline is not yet reversing, at least it is slowing down.

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Bagehot

Fancy a nice constitution?

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Why Iraq will make a referendum on the European constitution harder for Tony Blair to win

BEWARE post-European-summit euphoria. In 1991, John Major, Tony Blair's predecessor as prime minister, was convinced that Maastricht was his finest hour. By all accounts, Mr Major, against all odds, had played a blinder in securing Britain's opt-outs from the most intrusive aspects of the treaty. As he recalled in his memoir: “When I made a statement in the Commons on the outcome I was received with acclaim and the waving of order papers. It was the modern equivalent of a Roman triumph. Soon, it would be very different.”

Mr Blair also gave a pretty fair impression of triumphalism in the House of Commons this week on his return from agreeing the constitutional treaty in Brussels. It wasn't just that Britain had more or less secured all its cherished “red lines”. Mr Blair crowed that this summit, the first in which the ten accession countries had been present as full members of the European Union, had vindicated his belief that the EU was changing. The angry flailings of Jacques Chirac and the failure of the French and the Germans to secure the vacant presidency of the European Commission for the federalist Belgian prime minister, Guy Verhofstadt, was a sign of the times. How ridiculous of the Tories, Mr Blair taunted, to want to marginalise Britain at the precise moment that things were going our way. Behind Mr Blair, Labour MPs cheered and waved their order papers.

Mr Blair's premiership will not, like Mr Major's, be destroyed by Europhobe MPs from his own party—although he has a few more of those than is generally realised. With the pro-European Liberal Democrats in tow and the kind of majority that Mr Major could only dream of, the legislation to ratify the constitutional treaty will pass without difficulty. It is quite possible, however, that Mr Blair's time in Downing Street will be terminated by losing the referendum he was finally convinced he could not avoid.

In terms of the length of Mr Blair's tenure this may not matter much. The referendum will not be before spring, 2006. Most people close to the prime minister believe that he has pencilled in his tenth anniversary in office as the right moment to depart—about a year after the intended date for the referendum. But for Mr Blair to quit in the aftermath of such a defeat would be personally devastating. When Mr Blair has talked about ending once and for all Britain's historic ambivalence to Europe, he had something rather different in mind.

Not that this is what Mr Blair thinks will happen. Despite what one might have thought was a growing amount of evidence to the contrary, the prime minister's preternatural confidence in his own powers of persuasion is undiminished. He reckons that once people know the facts and understand the arguments, opposition to the constitutional treaty will be reduced to a hard core of irreconcilables. Furthermore, he calculates that the Tories, 12 months on from a third successive electoral defeat and with yet another new leader, will be in no state to mount an effective “No” campaign.

He could be right. Opinion polls do indeed suggest that people's views about the constitution are currently shaped by ignorance and fears that could in theory be dispelled. But while Mr Blair knows well enough that securing a “Yes” from a predominantly Eurosceptical electorate will not be easy, he may still be underestimating the difficulties that lie ahead.

The prime minister's biggest quandary is how to make an upbeat case for a turgidly written document of 333 pages that is riddled with deliberate ambiguities. From the outset, the government has struggled to sound positive about the exercise. At first, Mr Blair said that a constitution wasn't really necessary. Then, when it became unstoppable, it was just a “tidying up exercise”. When that was no longer tenable, the government's emphasis switched to the heroic defence of its “red lines”. Damage limitation is the tried and tested approach by British governments when faced with something from Europe they don't really

like. But arguing that the treaty is relatively harmless won't create a groundswell of enthusiasm for it. Similarly, drawing attention to some sensible, largely technical measures designed to make the enlarged union function is a feeble retort to those who see a plot to strip Britain of its sovereignty.

Weapons of mass distrust

Mr Blair fervently believes the Tory policy of partial disengagement is hostile to Britain's national interest. But experience has dampened his youthful ardour for Europe. His enjoyment of last week's summit was the exception to the rule. He still feels personal hurt over Iraq and is dismayed by the anti-Americanism of the French, the Germans and the new Spanish government. Along with Gordon Brown, the chancellor of the exchequer, he fulminates over continuing opposition to economic liberalisation and he regards the refusal to speed reform of the common agricultural policy as morally repugnant. Unable to summon up any real passion for the EU as it is, yet forced to respond to the relentless anti-European propaganda in the best-selling newspapers, he is driven to conjure up an apocalyptic vision of what life for Britain would be like if relegated to the EU's margins.

This leads to what could prove to be Mr Blair's biggest problem. Because people think the prime minister cried wolf over Iraq, WMD and all that, they are disinclined to believe his dire warnings of the consequences of voting “No” over Europe. Worse still, the only reliably pro-EU voices in the media—the *Guardian*, the *Independent*, the *Mirror* and the BBC—are those which have worked hardest to destroy trust in the prime minister over the war.

The only way Mr Blair can hope to win a referendum on the constitution is by convincing enough people that “No” is, in effect, a vote to leave the EU. But even if he is right, how many will believe him?

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The second transition

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AFP

After 30 years of economic and political success, Spain is entering a new phase of democratic development, says John Grimond (interviewed here)

IT IS difficult not to like Spain, not to enjoy the atmosphere of such a civilised society and not to admire the achievements of its people. In under 30 years—Generalisimo Francisco Franco died in November 1975—Spain has emerged from dictatorship and international isolation, built a successful economy and established an effective democracy. Perhaps no other European country has achieved so much, on so many fronts, so quickly.

Yet Spain is also slightly ill-at-ease, slightly lacking in self-confidence. That was true even before the terrorists' bombs of March 11th that shook Spaniards to their bones, and the ruling People's Party of José María Aznar from the seat of government that it thought it had a lock on for another four years. Things were not altogether composed even then, and they are certainly more complicated now.

Much of what Spain has achieved is real enough. In less than a generation the country has established a democratic system in which parties alternate in government, and governments, on the whole, deliver the goods. Of course, the evolution has had some bumps: an attempted military coup in 1981, for instance, boldly squelched by King Juan Carlos, and a scandal during the Socialist administration of Felipe González in the mid-1990s about the use of death-squads against Basque terrorists. In both episodes the issue at stake was really the rule of law.

Nonetheless, all in all, Spain has developed not just a firm democracy but a system of governments that produce policies and implement them—in other words, they govern. Most notably, they deliver economic growth, which is why Spaniards are today about 75% richer than they were 30 years ago, and have seen their economy grow faster than the European average for nearly ten years.

Not surprisingly, democratic Spain has won the respect of other countries. Some have attributed this to the assertive leadership of Mr Aznar, who loosened Spain's ties with France and Germany, strengthened those with Euro-equivocal Britain and the uncompromising United States of George Bush, and brooked no nonsense from countries such as Morocco when they provoked him. After years on the fringes of international respectability, Spain has certainly started to count in the world. Mr Aznar saw the significance of this, yet the respect given to his country beyond its borders derived not so much from his strutting on the world stage as from the fact that Spain had become a country that worked. It was a

place to be reckoned with.

The contrast with Italy is instructive. Italy has been a democracy for about twice as long as Spain. It is richer and its population, at 59m, is nearly half as large again as Spain's, at 40m. Under Silvio Berlusconi, Italy, like Spain, has even aligned itself with Mr Bush's America and sent troops at his behest to Iraq. But how influential is Italy? Mr Berlusconi could hardly match Mr Aznar's 14 meetings with Mr Bush in 2002-04. He was not even invited to join Mr Aznar, Mr Blair and Portugal's José Manuel Durão Barroso at Mr Bush's summit in the Azores before the Iraq war in March 2003. Yet if Italy has been punching below its weight and Spain above it, that is not because Mr Bush found Spain's prime minister ideologically more congenial than Italy's. It is because Spain is a serious country.

Not too serious, fortunately. For those who seek trendy tapas bars, non-stop night life or inventive restaurants, Spain is the place. Good Spanish wine no longer comes only from La Rioja, any more than good Spanish cheese comes only from La Mancha. Spanish athletes excel on the golf course, the football pitch and the tennis court. Spain's singers have long been bringing down the world's opera houses. Now its dancers, such as Tamar Rojo, who performs with Britain's Royal Ballet, are entrancing international audiences, its actresses, such as Elena Anaya, are conquering Hollywood, and its directors, such as Pedro Almodóvar, are beguiling Cannes.

The cultural exuberance is even more conspicuous in architecture, Spanish-commissioned if not all Spanish-designed. The Agbar tower, a huge new skyscraper that has recently broken the Barcelona skyline, is just one of the many striking buildings going up across Spain in this burst of architectural fecundity. The trend was started by the citizens of the old industrial city of Bilbao, who were clever enough in the 1990s to persuade a first-rate American architect, Frank Gehry, to design them their own Guggenheim Museum (a spectacular titanium-clad clipper that now stands on the site of an old shipyard), and to get the Basque government to pay for it. Next they asked Spain's own Santiago Calatrava to design the city's stylish Sondika airport. Then they got Britain's Norman Foster to do their metro—whose stations are now known as *fosteritos*. Bilbao, once mouldering and mephitic, has never looked back.

Other cities are following suit. Barcelona has taken on Zaha Hadid, the Anglo-Iraqi winner of the 2004

Pritzker architecural prize, to design a Plaza de las Artes. She is also overseeing the development of another swathe of Bilbao, as well as designing a large building in Durango. Córdoba has asked the Netherlands' Rem Koolhas to plan its own urban project. Valencia has signed up Mr Calatrava to create a City of Arts and Sciences. And Madrid, not content with commissioning Britain's Richard Rogers to help finish its expanded Barajas airport, is undertaking five projects costing over €150m ($180m) that will together form a new cultural area to be known as the Salón del Prado.

The fiesta factor

Spain's cities have, for over a decade, been clever at promoting themselves, and thus the country as a whole, through international *fiestas*. Barcelona got a huge lift from the Olympics in 1992, and so did Seville from the Expo world fair that same year. Now Barcelona is holding a €326m jamboree called Forum 2004. In 2007 Valencia will hold, on behalf of the landlocked Swiss champions, the contest for sailing's oldest competition, the America's Cup. And Madrid is now running second in the stakes to hold the 2012 Olympics.

All this gives Spain the feeling of a place with a spring in its step. It undoubtedly helps to draw visitors and to make Spaniards feel they live in a modern, culturally vital society. Yet it also helps to show up those parts of Spanish existence that have not quite caught up with the times.

Evidence of such underdevelopment can be found in most areas of Spanish life. Spanish business, for example, is remarkably timid, deferential towards government and, with a few exceptions such as the clothing company Zara and the stainless-steel maker Acerinox, reluctant to venture beyond the Spanish-speaking world, even into Europe. Spain has few big international companies. The main ones are former state-owned giants that have been privatised—and whose boards were then packed by the government. Even companies that have no formal government connection often seek political approval for board appointments. The recent change of government has prompted many changes in corporate Spain.

Such upheavals are not confined to business. All sorts of institutions that in other countries might be independent—think-tanks, the judiciary, the country's main institute for projecting national culture abroad and the media, notably the state broadcasting system—have seen heads roll since the general election on March 14th, just as they have rolled after previous general elections. The practice reflects the relative youth of Spanish democracy: it has not had time to develop the dense undergrowth of independent organisations that enrich older democracies—a non-partisan press, forthright professional associations, self-confident universities, sceptical non-government bodies, outspoken individuals and so on.

Spain also lags in some social areas such as homosexual rights and the role of women. Domestic violence is a big problem—no more so than elsewhere, but perhaps less recognised until recently. The Catholic church still receives much of its income through a share of Spaniards' income tax, albeit only by individual agreement. These and other matters will come up for review, and indeed the new government is already tackling many of them.

Two other problems—immigration and regionalism—are of a different nature: they are not directly connected with the growing pains of an adolescent democracy, but they may prove much harder to deal with. A country of emigrants has rather quickly turned into one of immigrants, some of whom may prove difficult to absorb. And a country that has already devolved more power from its centre than any other in Europe cannot quite understand why many of its citizens are still not satisfied, whereas others think it has already done too much. A large proportion of Spaniards, it seems, want to live in a plural state of several nationalities, whereas another large proportion see their country as a unitary state infested by tiresome regional romantics.

All this adds up to a country more tentative and less self-assured than it appears. Four months ago Spain seemed ready to accept the stern rule of Mr Aznar, with his Atlanticist foreign policy, traditional approach to social issues and unbending attitude towards Basque, Catalan and other nationalists. A moment later the self-same place appeared to be rejoicing at a new government's snubbing of the Americans, its support for left-wing causes and its new spirit of conciliation towards the regions. Could a country capable of such a rapid swing be anything but a bit confused?

Fickle affections

In truth, Spain was never quite as self-assured as it seemed, nor quite as in love with Mr Aznar as foreigners imagined—even if some of those who now affect to despise the former tax inspector with great-power pretensions were quite ready to vote for him a few months ago. It is likely, however, that this year's dramatic election will come to be seen not as a by-product of a terrorist attack that happened to lead to a change of government, but as the natural end of the first era of Spain's post-Franco transition to democracy. What follows now is a second era—a transition from a simple democracy to a more complicated, more sophisticated one.

The new government under José Luis Rodríguez Zapatero certainly has the opportunity to launch this second transition. It has lost no time in bringing Spain's troops back from Iraq, in proffering an open hand to Spain's traditional partners in Europe and in embarking on a programme of social change, all the while promising to stick to the old certainties of sound financial housekeeping, and dialogue and consensus all round.

Popular as this is at present, it may not be adequate to meet the realities of Spain's new circumstances: a richer country whose citizens must now find higher-earning and more productive jobs than the unskilled ones of the past; a more diverse society which now includes multitudes of North Africans and Latin Americans; and an internally strained society that has to manage the different ambitions of its constituent peoples—Basques, Catalans, Galicians and the rest—within a tolerant, sophisticated democracy. Mr Zapatero has his chance to start shaping the new Spain. What are his prospects of success?

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From A to Z

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Mr Aznar suffered a Shakespearean ending. Mr Zapatero has made a more quixotic start

SELDOM has hagiography turned so swiftly to reproach. Well before March 14th, the date that Mr Aznar himself had chosen for his departure from Spanish politics, the encomiums were pouring forth. Not only had he given Spain eight years of economic growth (an average of 3.2% a year), sound management of the public purse (no budget deficits like those of France, Germany and Italy), lowish inflation (2.6% in 2003) and a cut in the unemployment rate from 22% to 11%, but he had also had the resolve to beat back ETA (about 200 arrests in 2003, including those in France, and only three killings) and take Spain into the front line of Mr Bush's war against terror in Afghanistan and Iraq.

The voters did not care for all of it: 90% of Spaniards, in poll after poll, said they opposed the war in Iraq and Spain's part in it. But, since most of them also told the pollsters that they would vote for Mr Aznar's party under his chosen successor, Mariano Rajoy, they seemed to be implicitly acknowledging that they admired his leadership, and perhaps also his readiness to take them even where they did not want to go. That, however, proved to be a grave misreading of the voters' views.

In what is still a fairly conservative country, it is striking how few people now have good things to say about Mr Aznar. Forgotten, largely, are the achievements of his first term, when he presided over the continued devolution of power to the regions—admittedly driven by his government's dependence on regional parties in parliament. Forgotten, too, or taken for granted, are the decency and effectiveness with which he mostly governed (notably, again, in his first term), and which were in marked contrast to the sleaze at the end of the Socialists' previous period of office.

Not least among his achievements was to turn the People's Party (PP), often seen as Francoist in its sympathies, into a respectable centre-right organisation. All this is eclipsed, if only temporarily. Instead, the failings of the second Aznar term are now remembered, most of which come under the headings of rigidity and arrogance.

Top of the list, of course, is the attempted manipulation of public opinion in the period between the bombs of March 11th and the election of March 14th—the attempt to place the blame on ETA, the telephone calls to the media assuring them of ETA's guilt, the foreign minister's request for a specific condemnation of ETA in a UN resolution of sympathy, the state television's decision to drop an evening showing of “Shakespeare in Love” and run instead a documentary on the evils of ETA, and so on. This attempt at superspin—largely exposed by text-messaging on mobile phones—so infuriated a large group of Spaniards, most of them young, many of them too disillusioned with party politics to want to cast their ballots at all, that they went out and voted Socialist in disgust.

Mr Aznar is to this day uncontrite, conceding only that “perhaps Spanish public opinion was not sufficiently aware, until March 11th, of the extent of Islamic terrorism”. He telephoned Mr Bush to express his regret about his successor's decision to withdraw Spain's troops from Iraq. Some in his party believe the election was stolen from them. Most others put the episode down to simple hubris.

AFP

Mr Aznar's arrogance certainly had costs beyond his party's loss of the election in March. Coupled with his inflexibility, it needlessly antagonised all sorts of people who might have worked with him. The general hostility to Spain's Iraqi venture would surely have been less intense had the prime minister been ready to explain his reasons for it to the electorate.

As it was, he would not even go before parliament at the outset and make his case for sending troops to Iraq. Instead he merely asserted that it was good for Spain, and then grudgingly allowed a secret parliamentary vote, in which the entire PP was evidently whipped into line. It was only last

December, eight months after the war began, that Mr Aznar addressed parliament about Iraq, on a day of mourning for seven intelligence officers just killed.

The alienation from Spain's partners in Europe could also have been tempered by a more diplomatic approach. Mr Aznar was right in seeing that Spain had an interest in good relations with both North and South America, but these could have been achieved without antagonising two of its neighbours, France and Morocco, and a potentially useful friend like Germany.

His decision last December to oppose, with Poland, any change to the majority-voting provision of the European Union's Nice treaty was even less defensible: the treaty, stitched up in haste in December 2000, gave Spain and Poland almost the same number of votes as much more populous Britain, France, Germany and Italy, and the system clearly needed to be changed if the enlarged EU were not to be immobilised for ever. The refusal of the Spanish and Polish governments to compromise led to an impasse over the proposed EU constitution, which was therefore in limbo when the Union took in ten new members on May 1st.

The day Spain changed

A similar obtuseness latterly marked Mr Aznar's relations with most of Spain's nationalists. Perhaps influenced by his dislike of ETA—which very nearly killed him, in a bomb attack in 1995—he outlawed Batasuna, ETA's political wing, in 2002, depriving the state of a possible interlocutor with the terrorists. He also became less and less tolerant of other nationalists. Indeed, he grew increasingly prone to bracketing together all Basque nationalists, whether pro-violence or anti-violence, and refused to talk to the Basque premier, Juan José Ibarretxe, from 2001 on, even though Mr Ibarretxe's non-violent party had shown itself in successive elections to be the Basque region's most popular.

Many Basque nationalists are rather conservative—natural allies, it might be thought, of Mr Aznar's PP. Catalonia's nationalists in the Convergence and Union (CiU) party are even more natural partners, and indeed kept Mr Aznar's party in office during his first term. But once that necessity disappeared, so did any affection between the two. Mr Aznar increasingly seemed to regard all nationalist demands as equally outrageous, no matter who made them, and not surprisingly his party was fiercely punished in Catalonia's regional election last November. The CiU, equally unsurprisingly, is now grouped in the European Parliament with the other mainstream nationalists.

The Spanish electorate might well have forgiven the PP for some of the shortcomings of its outgoing leader, such as his handling of the wreck of the *Prestige*, a tanker that polluted a long stretch of the Atlantic coast in 2002, or the misjudgments that led to a general strike that same year. Strangely, Mr Aznar's more trivial foibles seem to have caused greater annoyance: his delight in putting his feet up on a table and smoking a cigar with Mr Bush at a G8 summit in Canada, for instance; even such *folies de grandeur* as holding a flamboyant wedding for his daughter in the Escorial monastery, near Madrid, where Spain's monarchs are traditionally buried.

Yet these too could all have been overlooked. His economic record, his success in weakening ETA and his impending departure could have been enough to ensure a victory for the PP under Mr Rajoy. But in the event he was undone by his response to the bombings, and so was his party.

The voters' revenge

Mr Zapatero's Socialists have been the main beneficiaries. The “certain” losers of the March election suddenly found themselves victors, and the poll for the European Parliament on June 13th suggests that their popularity has not diminished since. This in itself is evidence that the vote was not a passing reaction to the Madrid bombings that killed 191 people and injured 1,430. Still less was it a capitulation to terrorism, or any sort of attempt to appease Muslim attackers. Spain has lived with terror for over 30 years, during which more than 800 people have been killed by ETA. Throughout this time the Spaniards have shown no inclination to yield.

EPA

The voters were even happier to see them back

On the contrary, they have taken to the streets in throngs to express their disgust with the perpetrators of terror and their sympathy for the victims—notably on March 12th, when 11m people, over a quarter of the population, joined dignified demonstrations in cities across Spain. As William Chislett, of the Elcano Royal Institute, has pointed out, had ETA taken responsibility for the bombings, the PP would certainly have been returned with another absolute majority. As it was, the incoming Socialists quickly rededicated themselves to fighting terrorism, an aim to which they were already pledged in a formal anti-terrorist pact signed with the PP in 2000.

The Socialists came to office as surprised as everyone else that they were there (though Mr Zapatero protests otherwise), and utterly unprepared. Worse, they were encumbered with an election manifesto written in the belief that it would not have to be implemented and so promising a host of reforms that no prudent finance minister would want to pay for. Even so, the voters would surely have forgiven them if they had then explained that unforeseen circumstances made it impossible for them to do all that they had vowed.

So why was Mr Zapatero's first act to say that he would pull Spain's 1,300 troops out of Iraq? This, if anything, was an election commitment that could have been reconsidered in the light of the bloodiest terrorist attack in Europe since Lockerbie in 1988. And the case for reconsideration was strong. Though the withdrawal was genuinely an acknowledgment of the desires of a great majority of Spaniards, it was capable of being construed as a victory for terrorism. Mr Zapatero had himself once said that Spain's alignment with America had put it on the target list for international terrorists. So might this decision not have been seen as an attempt to get off that list?

Appeasement was certainly how many Americans would see it—Donald Rumsfeld is said to have also called it an act of cowardice—and possibly how al-Qaeda and its sympathisers would too. The withdrawal could at least have been postponed, but instead it was accelerated as Mr Zapatero quickly abandoned his initial condition: that it would happen only if the UN had not taken control of Iraq by June 30th. Instead, the new prime minister thumbed his nose at America and appeared to concede to terror as needlessly, it might be said, as Mr Aznar had so often needlessly annoyed those he disliked.

It could equally be said, in Mr Zapatero's defence, that he had not intended to withdraw Spain's troops so precipitately until it became clear, first, that no UN handover was in prospect and, next, that the troops were being asked not to help in stabilisation and reconstruction, as understood in the original mandate, but to take part in “an offensive strategy” against Muqtada al-Sadr in Najaf. Mr Zapatero was always at pains to point out that Spain had 3,000 peacekeeping troops elsewhere, and was ready to strengthen its force in Afghanistan. And he has recently been much more restrained about Mr Bush's policies.

Keeping a promise

No doubt Mr Zapatero also wanted to avoid the experience of one of his predecessors, Mr González, who was re-elected in 1986 vowing to take Spain out of NATO but soon reversed himself and ended up, after a referendum, cementing its membership. Yet perhaps the most decisive consideration throughout for Mr Zapatero was the cries of “Don't fail us!” rising from the crowds of young voters in Madrid after the election. The promise to bring the troops home had been made by the Socialists over and over again for a year. Mr Zapatero evidently minded more about his bond with the voters, especially the 2m voting for the first time, than about anything else.

That, however, hardly explains the other surprise of Mr Zapatero's first post-election utterances: his readiness to make concessions over Spain's EU voting rights. The Socialists had always accepted the double-majority system that the PP jibbed at, and their pro-EU sympathies were well known. But to promise concessions without getting anything in return—nothing of consequence was, in the event, forthcoming—looked like foolishness or, to be charitable, inexperience.

Perhaps it was. Mr Zapatero has some old hands in his government, including the canny Pedro Solbes as economy minister, not even a member of the Socialist Party and just the man to reassure the financial markets. But the 43-year-old prime minister himself, whose youthful appearance has earned him the nicknames of Bambi and Babyface, is a novice. He will just have to learn on the job. It should not prove impossible for a man who was chosen as leader of his party chiefly because he was a moderniser, and who, by even his opponents' accounts, fought an effective election campaign.

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Oh, to be in Europe

Jun 24th 2004
From The Economist print edition

...if only Spain's interests didn't also pull it west

UNPREPARED the Socialists may have been, but that has not stopped them announcing a stream of policies on everything from abortion to water. The more difficult domestic issues, however, can wait. Foreign affairs are different: Iraq was from day one too big to ignore, and the EU has a calendar of summits and budgets that demands attention. Spain must very soon decide whether its interests lie primarily in continental Europe, as the Socialists say, or across the Atlantic to the west, whither Mr Aznar yanked his country's foreign policy.

In fact Morocco, to Spain's south, is the first country that Mr Zapatero has visited as prime minister, taking the sensible view that Spain should be on good terms with a neighbour just 13km (eight miles) away. Similar thoughts have occurred to Spanish leaders before, but relations between the ex-colonial master and its part-protégé—most of the country used to be French—have been strained for years. The Moroccans resent the continued existence of two Spanish enclaves, Ceuta and Melilla, on their northern coast. They also bridle at the periodic support given by Spaniards to the Polisario Front that seeks independence for Western (formerly Spanish) Sahara.

For their part, the Spaniards resent Morocco's claims not just on the two enclaves but on various islets, one of which, Parsley island, it invaded two years ago in a comic incident that had to be defused by Colin Powell, America's secretary of state. In addition, Spain would like to see Morocco reduce the numbers of migrants who cross the Strait of Gibraltar—a desire reinforced by the belief that most of the bombers on March 11th were Moroccan.

Unfortunately, it is hard to see how any of these problems can be easily settled. If Morocco is not quite an absolute monarchy, it is certainly not a democracy and, despite some recent reforms, it is not about to give independence to Western Sahara. For its part, Spain will not yield up Ceuta and Melilla. There is scope for better co-operation on terrorism and perhaps on migration, but Morocco has no magic answers: suicide bombers killed 33 bystanders in Casablanca in May 2003, and the flow of migrants will not cease until Morocco's living standards approach Spain's.

That will not happen for years, even though Spain could do more to hasten the day. It could, for example, give Morocco more aid. Much more useful, though, would be a decision to abandon the practice of growing (with Moroccan labour) expensively irrigated vegetables and cotton in the arid south of Spain, and instead to import these crops from Morocco. Mr Zapatero has had the good sense to cancel a controversial plan to take water from the River Ebro in northern Spain down to the vegetable farms and golf courses of the parched south. But Spain's uneconomic farming practices will not end without a thorough reform of the EU's common agricultural policy, which Spanish farmers, and their governments (including the new one), stoutly resist.

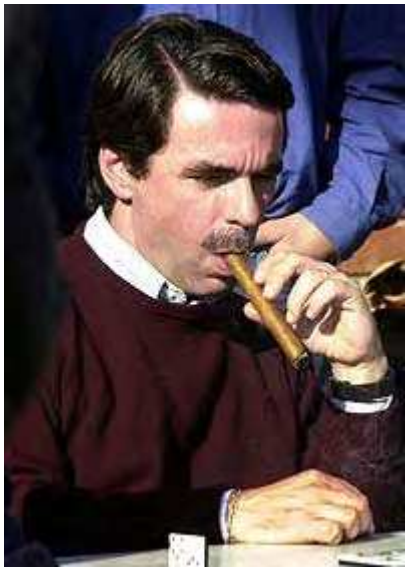
In fact, most solutions to Spain's Moroccan problems, if solutions exist, have an EU component. The EU would not condemn the invasion of Parsley island because France, which sees itself as a rival to Spain in their former colony, vetoed it. Terror, migration, farming and fishing (another source of tension) all demand joint European as much as bilateral action.

Mr Zapatero would be the first to admit this, but will he also come to see that Mr Aznar's attitude, flinty as it certainly was, also had some merit to it? Mr Aznar's success in getting Spain a disproportionate number of votes in EU decision-making was, for instance, some compensation for the fact that Spain stands to lose in several ways from the expansion of the EU.

AP

First, Spain almost certainly moves from being the biggest net beneficiary of the EU's regional funds—to the tune of €8.4 billion in 2002—to being a

net contributor. Second, now that a clutch of much poorer countries have joined the club, Spain is no longer the low-wage economy of choice for foreign investors wanting to set up in the EU. That partly reflects Spain's economic success—income per person is now 87% of the average for the EU-15, compared with 74% when it joined in 1986—but the general drift of manufacturing jobs to eastern Europe that has taken place in recent months is likely to continue. Third, the EU's centre of political gravity has moved eastwards and away from the Mediterranean south. Even though several of the new members are Atlanticist in outlook, Spain has become more peripheral.



A whiff of superpowerdom for Aznar

The Spaniards like the EU. They associate it no doubt with their new prosperity and with Spain's return to the family of nations after nearly 40 years of semi-isolation. All opinion polls confirm its popularity. But Spanish business is also drawn west, to Latin America (where Spain has $87 billion invested, and which contributes 7% of its listed companies' earnings), and Mr Aznar was not alone in seeing a great role for Spain as the leader of an increasingly influential Spanish-speaking community abroad. There was some wishful thinking in this, but it is true that 350m people speak Spanish in Latin America, as do 30m in the United States. Indeed, Spanish has become much the most popular second language in the United States.

Mr Aznar saw more than this. He saw the merits of aligning Spain with an economically liberal Britain, which also had strong transatlantic links. And he wanted to tie his war on ETA, which was to some extent obsessive, almost personal, into Mr Bush's global war on terror.

Lastly, there was an unspoken recognition that Spain, even more than some other European countries, needed America's security umbrella. In many respects the Spaniards are deeply pacifist: though they backed membership of NATO in a referendum in 1986 and opinion polls showed they supported the war in Kosovo, similar polls suggest they would not want to see Spain fight even to defend Ceuta and Melilla. Much has been made of Spain's contingent in Iraq, but in truth it was purely symbolic. Spain spent just 1.2% of its GDP on defence in 2002, compared with an average of 1.9% for NATO's European members and of 2.6% for NATO as a whole. If Spain were threatened, it would turn not to the EU's would-be security system but to the United States.

All this suggests there could be pitfalls for Mr Zapatero if he were thought to be too accommodating in negotiations with the EU over, for instance, the budget; or if his clear dislike of Mr Bush's Middle East policies poisoned transatlantic relations (perhaps only for a while—he has already “aligned” himself with John Kerry).

Fortunately, his foreign minister, Miguel Ángel Moratinos, is a former diplomat with wide experience, albeit chiefly of the Arab world, not the United States. And the defence minister, José Bono Martínez, is no left-wing ideologue. Rather, he is the most conservative member of the government, if not always the most tactful. In any event these two may help to smooth relations with the Americans, particularly if they can keep the new government's promise to strengthen the diplomatic service, which has long been underfinanced and overpoliticised.

Going ape over a rock

Therein lies another opportunity for Mr Zapatero, if he wants to take it. One problem above all others occupies an utterly disproportionate amount of time in Spain's small and often overstretched foreign ministry. It is Gibraltar, the rocky promontory ceded to Britain under the Treaty of Utrecht in 1713. Spain considers it outrageous that Britain should still have a “colony” in Europe, and wages an intermittent guerrilla war of some pettiness against Gibraltar, recently banning liners that call there from then calling at Spanish ports.

Britain has made it clear that it would be ready to share sovereignty with Spain if the Gibraltarians agreed (they have made it equally clear they would not). Spain dislikes the principle of self-determination, perhaps because of the example it might set for its own regions. And it is adamant that it will make no deal over Ceuta and Melilla: after all, Morocco did not exist when it nabbed them in the 15th century. It sees no equivalence to Gibraltar. Others see hyprocrisy, and a prickly nationalism unbecoming to a modern democracy.

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To market, to market?

Jun 24th 2004
From The Economist print edition

A fat pig awaits, if only the Socialists will do to the economy what the PP did not

IN MANY respects Mr Zapatero and his team appear to have inherited an economy working so well that they can only enjoy it, or destroy it. In truth, they have a great opportunity to improve it. In doing so they could show that they are not doctrinaire socialists wedded to the sort of Franco-German welfarism that Mr Aznar claimed to dislike, but more market-friendly than ever he was. It will be a test.

The PP's stewardship of the public finances was exemplary, but Spain's splendid record of economic growth in 1996-2003 owed as much to the EU as to the government's management. Mr Aznar took over an economy set for take-off. Tax revenues rolled in just as interest rates began to drop in anticipation of Spain's membership of the new euro. Confidence rose and debt-service costs fell, as did public spending and then the budget deficit. When the euro was launched, low interest rates—real short-term rates have been negative for two years—set the scene for a big boost to both consumption and building.

The PP government undertook a large privatisation programme, but it did not exploit its good economic fortune to make the sort of changes that would have created a truly liberal market economy. The big state-owned enterprises in electricity, natural gas, oil and telecoms were privatised, but the state kept golden shares (since ruled illegal by the EU), picked the bosses and, directly or indirectly, appointed most of the directors.

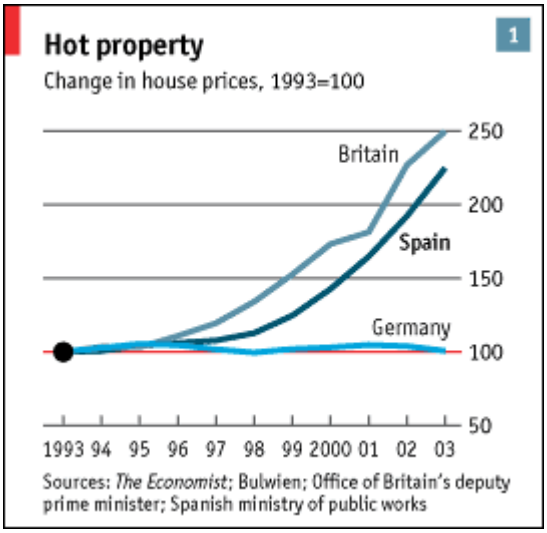
Deregulation was similarly less than thorough. The competition court is weak and, in the big privatised industries, as Professor Jordi Gual of the IESE Business School in Barcelona points out, the aim was not so much to cut prices, which remain relatively high by EU standards, or increase consumer choice; rather it was to promote strong firms with the financial muscle to enter markets abroad and defend themselves from foreign takeover.

The first problems for the new government are the demand for housing, which is such a large component of general economic growth, and the supply of labour, which also drives growth, though by boosting jobs, not productivity. Spain made a start on 700,000 houses last year, four times as many as Britain. Even so, prices for new Spanish houses rose 18.5% and for existing ones 16.7%. The boom continues, fuelled partly by foreigners drawn to Spain by the thought of a house in a sunny part of the euro area, partly by share-shy Spaniards looking for an investment. The upshot is that though 3m-4m houses stand empty and a similar number are used as secondary residences, many young Spaniards cannot afford even the smallest flat, and thousands of workers turn down job offers that involve moving house because they cannot find a house to move to. At the same time household indebtedness has risen sharply (nearly half of the average family's disposable income goes on servicing housing debt), while some 40% of Spanish capital stock is in nothing more productive than property.

The government has set up a housing ministry, unknown in Spain since Franco's day, and talks of creating an agency to help create a market by assuming some of the risks involved in renting. The aim is to test the agency idea in a few big cities. It does not have to be a triumph to help: even if it brought only 10% of the housing stock into the rental market, that would be a doubling. At present, nearly nine out of ten houses in Spain are owner-occupied, much the highest proportion in Europe. But no one expects quick results, partly because the high price of housing also reflects the high price of development land, which in turn reflects a scarcity artificially created by local governments that benefit from the shortage. So the system of local-government finance also needs reform.

The labour problem is equally difficult. Though 3m-4m jobs were created under the Aznar government, Spain still has an unemployment rate of 11%, the highest in the EU 15, bar Belgium's. Moreover, about 30% of those in work are on short-term contracts, and many in the black economy have no contracts at all. This reflects the unions' ability to bargain up wages and the compensation bosses must pay when a job disappears, whatever the reason.

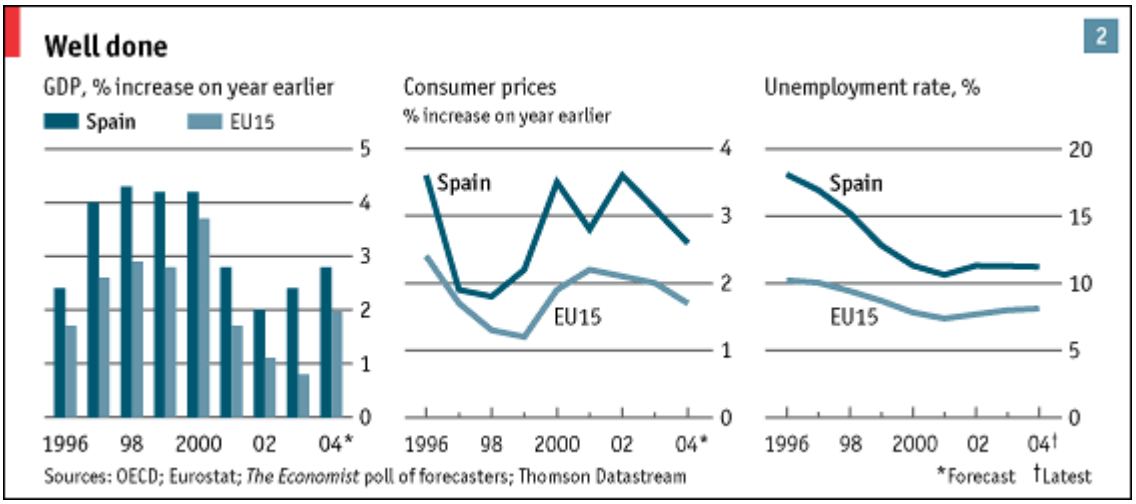
The roots of unemployment



The trouble really began with Franco, who wanted full employment at the expense of wages, and so made it all but impossible for employers to get rid of anyone (except on political grounds). Not surprisingly, when they could, the bosses substituted capital for labour. Excess labour was exported to Europe. With democracy, the unions won the right to increase wages while keeping their no-dismissal privileges. Unemployment, and then short-term contracts, ensued.

The new government has changed the national-insurance system to encourage the creation of more permanent and fewer short-term jobs. But the collective-bargaining system, in which negotiations are conducted by sector at national or regional level, has to change. Sceptics believe that Jesús Caldera, the new labour minister, is not the man for a fight with the unions; he has already announced an increase in the minimum wage (of 6.6%), in an economy where onlookers like the IMF and the Organisation for Economic Co-operation and Development (OECD) worry about both wage increases and productivity. If Mr Zapatero is nonetheless ready to have a showdown, it would be a sign of his mettle: Mr Caldera is perhaps his closest ally.

Other pressures will crowd in upon the new team. Mr Solbes is well aware that he faces “very tough” negotiations with his colleagues before the September budget. The government is committed to lots more social spending—which has been falling as a share of GDP since 1994 and, at 20%, is well below the EU-15 average of 27.5%—as well as more foreign aid, more police and such projects as extending the high-speed railway to Barcelona. At the same time Mr Solbes directly controls less than half the economy—the remainder is in the hands of the regions—and the government is dependent in parliament on regional parties.

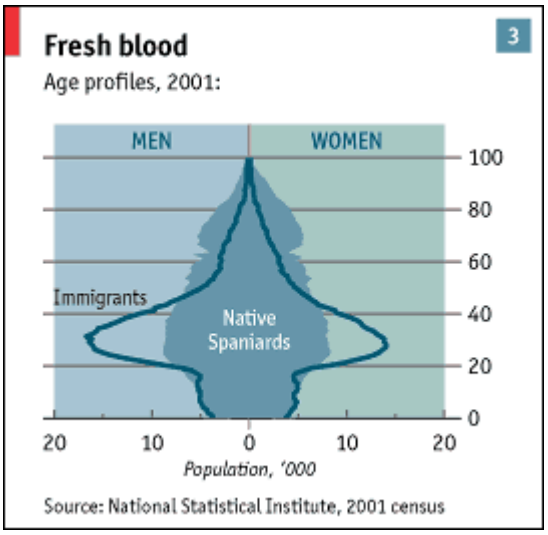


Nonetheless, he is pledged to balance the budget over the economic cycle, as befits the stern guardian, until recently, of the EU's growth and stability pact (as the monetary commissioner in Brussels). The budget was just in surplus last year, but this year is likely to be in deficit to the tune of 0.9% of GDP. With the economy expected to grow at about 3% in 2004, shouldn't Spain instead be running a big budget surplus, so that it can run a deficit when the cycle demands it? Aha, says Mr Solbes, it all depends on when the cycle is said to begin and end.

No one expects Mr Solbes to be profligate. The harder question is whether he and his colleagues will prove to be liberalisers. Some people already detect worrying signs of a hankering for “national champions”: Endesa, the biggest electricity supplier, has been talking to La Caixa, the biggest savings bank (which happens to control a water company and the former gas monopoly), about the formation of a conglomerate offering the cross-marketing of water, gas and electricity. Spanish Socialists who take their cue from France might welcome such a merger.

However, the budget minister, Miguel Ángel Fernández Ordóñez, is likely to push for market reforms, as is Miguel Sebastián, the prime minister's economic adviser. Mr Fernández Ordóñez has already shown his lack of socialist dogma by saying he would not rule out the privatisation of the state's hideously indebted television company; and Mr Sebastián, who was chief economist at Banco Bilbao Vizcaya Argentaria, Spain's second-largest bank, is known to favour a flat-rate income tax. Indeed, he was fired from his job at BBVA at the request of the Aznar government for his work on this subject; so too was his counterpart, Fernando Fernandez Mendez de Andés, at Santander Central Hispano, the biggest bank, for the same misdemeanour.

The tax system is certainly due for reform. Evasion is widespread—Spain's black economy is commonly put at over a fifth of GDP, nearly as much as Italy's—and too many poor people pay too much tax, while too many rich pay too little. The seriously rich need pay very little indeed, thanks to vehicles such as family-owned mutual funds or companies which enable them to pay just 1% of realised gains and nothing at all on undistributed dividends.



Mind your three Ps

A responsible government would soon tackle three other issues—prices, productivity and pensions. Price inflation is reducing the competitiveness of Spain's exports, especially in Europe. But holding prices down will be painful. Any closing of the differential with other countries depends, at least partly, on cutting wage costs through labour-market reforms.

Productivity is also related to the labour market, though any improvement here will involve efforts on a variety of fronts including education, bringing women into the workforce, and research and development. Everyone is agreed that Spain spends too little on R&D (about 1% of GDP, which is roughly half the EU's average and roughly a third of America's), and that it makes too little use of technology. Spain's banks are automated and efficient; likewise Inditex, which owns the fashion chain Zara, makes clever use of technology, albeit of a fairly unsophisticated kind. But Spain has been slow to embrace the internet—only 23% of households were wired in 2002—and its universities are weak in science and technology.

The OECD last year called for “an ambitious and speedy reform” of the pension system to bring retired people's pensions more closely into line with their contributions, and to slow the growth of pension spending after 2015-20. One difficulty is that, while Spaniards' life expectancy is growing—that is, the population is getting older—Spanish women have lost their eagerness to have babies. The fertility rate (the average number of children per woman) dropped from 3.0 in 1967 to 1.3 in 2001, well below the replacement rate of 2.1. It is now one of the lowest in the world. The result is that, even with immigration, Spain is in for a demographic shock, which, though it will strike later than similar shocks in most other rich countries, predicts the OECD, will be more severe.

The new government says it will extend monthly payments of €100 a child to non-working mothers to encourage them to breed, but pension reform is also needed. The OECD suggests a first step would be to base pensions on workers' contributions over their entire career, not, as at present, over the final 15 years.

No government could put all this right overnight. But by fostering competition, Mr Zapatero could stimulate the necessary changes. If he pressed on with privatisation, strengthened utility regulation and the competition court, and improved corporate governance, Spain would have a competitive economy, with businesses strong enough to venture out into the non-Spanish-speaking world.

That was at least part of what was supposed to happen when Mr Aznar joined other European leaders in Lisbon four years ago to pledge themselves to making the EU“the most competitive and dynamic knowledge-based economy in the world” by 2010. Like most EU countries, Spain still has a long way to go.

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Europe's magnetic south

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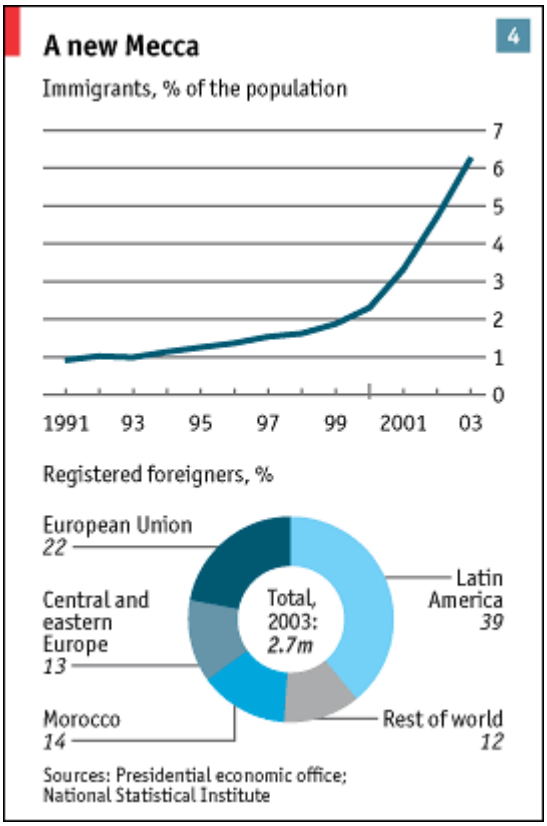
Spain's immigrants are generally well treated, but they are not integrated into society

THE two most striking facts about immigration in Spain are how recent the phenomenon is and how well the Spaniards have reacted to it. The worry is that the two may be linked. Will the hospitable reaction disappear when the newcomers are no longer so new?

For generations Spain, especially its poorer parts, such as Galicia, sent people out into the world. Only in the past dozen years or so has the world been sending more back than it received, and only in the mid-1990s did migrants start arriving in large numbers (see chart 4). As a result, though foreigners now constitute about 6½% of the population, the proportion is still smaller than in most other west European countries. Moreover, despite areas of concentration in central Barcelona and Seville, and parts of Madrid, such as Lavapiés and Cuatro Caminos, there are few ghettos. In 2003 four-fifths of the immigrants lived in six of Spain's 17 regions—Andalusia, Catalonia, Madrid, Valencia and the Balearic and Canary islands.

They come from all over: among the 191 people killed in the March 11th bombings were 47 people from a dozen different countries. At that time of day—the bombs went off on commuter trains early in the morning—these people were going to work, just like most of the Spaniards who died; they were not tourists.

Of the 2.7m foreigners in Spain, about 22% are from the EU 15, another 13% from other (mostly east) European countries, 39% from Latin America and 20% from Africa, including the Maghreb. Ecuador sends most (14.7% of the total), then Morocco (14.2%) and Colombia (9.2%). Those, at least, were the figures in January 2003 for both legal and illegal immigration, based on the population register, which illegals can sign without fear of deportation, and must if they want medical treatment or schooling for their children.



Bye-bye babies

Spain needs immigrants, not least because it will soon face a labour shortage. In 1976, about 700,000 babies were born in Spain . This year, as in each of the past 20 years, the number will be between 400,000 and 450,000. Demographers expect the group of working-age Spaniards to start shrinking around 2010, after which the demand for labour can be met only by immigration.

But even if plenty of Spaniards were available—and at present Spain has the second-highest unemployment rate in the EU 15—most will not do a lot of the jobs that need doing. Immigrants will. Thus they can be found picking strawberries in Huelva in the south-west, tending other vegetables under the sea of polythene that covers most of Almería over to the east, and everywhere working on building sites, looking after the elderly, washing dishes and satisfying the lust of men who seek the services of prostitutes. Once established, they often start to specialise: in Catalonia, the Chinese tend to go into textiles, the Pakistanis into the distribution of gas cylinders, and so on. Some also come to Spain to retire—which is why more houses in Majorca are said to be owned by Germans than by Spaniards.

But in general immigrants in Spain behave much like immigrants everywhere else. That means they put

more into the kitty than they take out. They are net contributors both to the tax and to the welfare system, according to the OECD,and they have already turned round the fortunes of the pension system, even if the respite is temporary: today's immigrants will themselves one day retire. For the moment, though, they are economically a boon.

Still, the immigration system is a mess. Last year, after talks with employers and others, the government decided it would offer about 10,000 permits for workers under contract. In the event, only about 3,500 of these were taken up. Any employer who needed labour found it much easier and less bureaucratic just to go down to Atocha station in Madrid, or similar places elsewhere, and pick up a paperless immigrant. Yet, though fewer permits were issued for contracted workers, the total number of work permits actually issued turned out to be nearly 130,000. Why? Because most of them were given to the relations of people already legally resident, or to asylum-seekers (15,800); or to people who had been legal but needed their papers renewed (21,500); or to others who had lived illegally for three years, after which they could apply to become legal (67,000). The remainder (25,000) received short-term work permits for seasonal work.

The system clearly needs to be reformed in order to reduce the number of these unplanned arrivals, which lead to many people living in a legal penumbra. The EU reckons 800,000 illlegals were resident in Spain last year. Several analysts, such as Rickard Sandell of the Elcano Royal Institute and Jordi Sànchez i Picanyol of the Jaume Bofill Foundation, think Canada's system has much to offer Spain, allowing a better match between supply and demand and giving government more control over the flow of immigrants.

Without that control, some of Spain's immigrants will certainly remain vulnerable to exploitation and even attack. Despite a few incidents, very little organised racism seems to exist at present. Perhaps that is because Spain is not at heart a racist country. As José Varela Ortega of the José Ortega y Gasset Foundation points out, the expression “bloody foreigners” simply does not exist in Spanish. But at least some French students of immigration see in Spain a situation ripe for a racist party like France's National Front.

Fortunately, the growth of immigration in Spain has coincided with a period of economic prosperity. A recession might well produce a backlash against those who have found it hard to fit in. They would probably not be the Latin Americans who can speak Spanish, and who often look like Spaniards. More likely, they would be French- or Arabic-speaking Moroccans.

Al-Andalus revisited

The claim is often made that the centuries of Moorish rule in pre-1492 al-Andalus—which comprised most of modern Spain and Portugal, excluding the kingdom of Asturias in the north—were a period of great religious harmony, commercial success and cultural fertility. The Moors certainly left their mark on Spain, and not just in the Alhambra in Granada and the Great Mosque, now a cathedral, in Córdoba. Poetry, art and scholarship also flourished in what was a genuinely Spanish, albeit Moorish-influenced, civilisation.

Here today, more tomorrow

Today an Islamic revival of a kind is under way in parts of Spain, notably Granada, where a new Grand Mosque opened last July, for the benefit not just of Moroccans and Syrians but of the 1,000 or so local converts from Christianity too. But that does not mean that Spaniards really have a great affinity with

Muslims. Moroccans are undoubtedly culturally closer to Spaniards than they are to, say, Germans. But tales of the Moorish period tend to be romanticised, and anyway it was all a long time ago—except, it should be said, to Osama bin Laden, who has long held the loss of al-Andalus to be one of his main grudges against the Christian West.

That in itself might have been enough to make some Spaniards suspicious of the 600,000 Muslims in their midst, roughly 60% of whom are thought to be Moroccan. But after the events of March 11th and the arrest of several dozen people, most of them Moroccan, it would be odd if some Moroccans were not also suspected of worse. In fact, they are. According to *El Pais*, the country's biggest daily paper, the security services have identified over 300 potentially dangerous Islamists in Spain. Most of them are presumably Moroccan.

Many Moroccans in Spain are well aware of the dangers. Mustapha El M'Rabet of the Association of Moroccan Workers and Immigrants would like to see the teaching and practice of Islam much more integrated into Spanish life, and would like much greater regulation of the imams and their 250-odd mosques, many of which are no more than garages. He would also like to see much more being done for the Moroccans his organisation tries to help.

The government has a part to play in all this. It should certainly promote the integration of immigrants into Spanish society and do everything possible to prevent another outrage like that of March 11th. But it must also gain control of immigration and bring order to the labour market. None of these tasks is easy in itself. Together they look Herculean. Yet mass immigration is plainly a permanent fact of life for Spain. It would be tragic if it were accompanied by the emergence of a racist political party, or if Spanish society, generally harmonious, were to become intolerant of foreigners.

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A house of many mansions

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From The Economist print edition

Time to look at pluralism as a plus

PERHAPS the most awkward issue that confronts Mr Zapatero's government is that of regionalism—or is the word nationalism? That very uncertainty gives a clue to the delicacy of the subject. Viewed from Madrid—or Castile, from which both Mr Zapatero and Mr Aznar come—places like Catalonia and the Basque provinces are regions, and their quest for more power is regionalism. Viewed from Barcelona or Bilbao, the local people are nations, and nationalism is the name of the game.

Except it isn't a game. The tension between the centre and the periphery, or parts of it, is constantly felt in almost every aspect of Spanish politics, and for many it is deadly serious. Set aside, for a moment, ETA, the only group prepared to use violence to achieve its end, the creation of a Basque state. Though about 120,000 people are willing to support its now-banned political wing, Batasuna, no democrat is ready to defend its methods, and in this sense it is beyond the pale. But all the other regionalist parties, which can be found from Galicia in the north to the Canaries in the south-west, are more or less reasonable, and certainly non-violent.

Even so, the onlooker watching the Catalan television weatherman talking about rain falling “in the Spanish state” (ie, not in Catalonia), or his sports counterpart hyperventilating because the local rollerskate-hockey team has been accepted as a “national” one by an international federation, may well wonder whether nationalism and a sense of humour are at all compatible. The feelings of fury aroused by diehard Castilians on the other side can be just as absurd. Indeed, most Spaniards will not even contemplate the possibility of some part of the country seceding. For many, that would be treason.

Nothing is simple about Spain's regional politics. The country is federal in many respects, but not formally or symmetrically so and, though it is divided into 17 “autonomous communities”, their rights and responsibilities vary. No wonder. Spain never really was a unitary state, despite Franco's best efforts to make it “*España, una, libre, grande*”. Navarre did not join the parts reconquered in 1492 until 20 years later and, more important, Aragon, Catalonia and the Basques all kept their ancient identities to some degree. The Catalans made bids for independence in the 17th and 18th centuries, and got a good measure of it, three times, in the 20th century. The Basques have long struggled to preserve their language and culture, and have succeeded, to the extent that for centuries Spanish kings would go to Guernica in the Basque country to recognise the *fueros* (ancient rights) of the Basques.

Not everywhere had a strong regional identity, though the 1978 constitution has created regional demands from places such as Galicia, where many people speak the local language and which now has a nationalist party. Even Andalusia is getting in on the act, asking for a revision of its “statute”, the contract each region has with the central government. And invented regions, such as Cantabria, Madrid and Murcia, are fast changing from purely bureaucratic entities into something more economic and political, even if they make no cultural claims. All this annoys the Basques and Catalans, who feel their uniqueness is being diluted.

To most outsiders, many of these regions now have more powers than they know what to do with—a consequence of the *café para todos* (coffee all round) principle embodied in the 1978 constitution. The Basques have more powers than most, including responsibility for almost all tax-collection (a share of what they collect is handed over to the treasury to pay for foreign affairs, defence and the monarchy) and corresponding rights to spend it (social security is the only significant area outside their control). They even control their own police. Navarre has similar fiscal rights, and Catalonia is not far behind. Yet many clamour for more. What, and why?

Ask that of Josu Jon Imaz, the president of the Basque National Party (PNV), and you get an utterly reasonable answer. The Basques, he explains, are a nation. They want to be recognised as such, to have all the powers they judge necessary to control their own affairs and to take advantage of the rights of

representation that now exist in the EU for subnational governments.

So do they want to secede? Goodness gracious no, not now anyway. They do not even want to have a referendum on the question of secession. But they do want one to approve a proposal promoted by Mr Ibarretxe, the PNV premier of the Basque region, which Mr Imaz insists is really about changes to the Basque statute, but which many others describe as a plan for a referendum on self-determination: not a shall-we-secede question, of course, merely a do-we-have-the-right-to-ask-whether-we-should-secede question.

Reuters

Misunderstood Ibarretxe

The Ibarretxe plan infuriates most politicians, and both the Socialists and the PP are against it. But some think the fuss is excessive. Miguel Herrero Rodríguez de Miñón, for instance, a wise conservative who helped write the 1978 constitution, sees the plan as “a point of equilibrium”, which keeps the Basques' essential links with the Spanish state while giving them greater recognition as a people.

The premier of Catalonia, Pasqual Maragall, also wants a revision of Catalonia's statute, though as a Socialist, not a nationalist, he makes more modest demands. He would like more powers for Catalonia (over tax-collection, for example) and changes to the national Senate to make it more of a regional body. He would also like Catalonia to get in on the European act, greater recognition of Catalan as a language, the right of Catalonia to have its own court of final appeal for certain cases and so on. Strictly no talk of self-determination, though.

Yet critics wonder whether this will always be so, and with some cause. Enter into discourse with regional politicians and you encounter, on the one hand, apparently reasonable demands for greater control over this or that and, at the same time, increasingly abstract discussions about the need for recognition, a “free state associated with Spain”, sovereignty, self-government (as distinct from independence) and a variety of other notions that mean different things to different people, and sometimes different things on different occasions to the same people. Moreover, the more the nationalists extract from the centre, the more local voters show their gratitude by voting for them.

Insatiable

For this reason, the critics may well be right to say that nationalists are never satisfied: give in to their first requests and they never say thank-you and dissolve their party. Instead, they come forward with new demands. This is what Gustavo de Arístegui y San Román, a PP member of the central government from the Basque country, calls the “syndrome of revindication”—the nationalists' constant redefinition of their objectives in more extreme ways, coupled with a rewriting of history to keep alive the memory of old injustices. It is as familiar in Quebec as it is in Spain.

So are the charges and counter-charges that pass between centre and periphery. In Madrid, the visitor is told dark tales of what goes on in Catalonia and the Basque country. University teachers in Barcelona can lecture in English or Catalan, but not Spanish, it is said. If Catalonia were independent, the Council of Europe would find it in contravention of its duties to its Castilian-speaking minority. After over 25 years of PNV government (sometimes in coalition) in the Basque country, patronage is so rife that non-nationalists stand little chance of preferment. That is one reason why 300,000 people have left. And of those who stay to work, many prefer to live outside the region and bring up their families not just in relative safety but in an atmosphere free from nationalist political correctness. As for the nuttiest Basque ideologues, what other bunch since the Nazis has made such a fuss of blood groups, skull sizes and racial purity?

For their part, nationalists point out that their languages are as Spanish as Castilian, so why shouldn't they be allowed to use them in the supposedly regional chamber, the Senate? Why is it impossible to take a train, let alone a high-speed one, from Barcelona to Bilbao? (Answer, because the country has been developed on a Madrid-centred hub-and-spoke principle.) Why has there been no dispersion of national bodies round the country, except for one judicial training school to Barcelona? Why is even the Valencia-to-Majorca shipping company headquartered in Madrid? Why did the PP start flying a huge national flag in the Plaza de Colón in Madrid, with soldiers constantly saluting it, if not to annoy the regions?

AFP

Loathed as never before

Whatever the merits of these charges, one or two facts do stand out. The first is that no official figures are available to show which regions are net contributors to the public purse, and which are net beneficiaries. Yet any changes to the regions' political powers must take place within a financial system that guarantees a minimum standard of universal benefits throughout the country.

Spain is fortunate: it has no huge area of relative poverty, like Germany's east or Italy's Mezzogiorno. But some parts, such as Andalusia and Extremadura, are not well off, and it is the richer parts, notably Catalonia and the Basque region, that are most vigorous in demanding ever more control over tax and spending. It is already said that the Basques pay little or nothing in net terms to help the others; the only net contributors, it seems, are Catalonia, Madrid and the Balearic islands.

The danger is that further devolution will make the poor poorer. Mr Zapatero's economic team thinks the regions should contribute to the kitty according to their income, and receive according to their population. Whether this is the best principle should be a matter for negotiation, but a clear and simple system of regional finance is needed, which would show exactly how much each region transfers to and from the central government. Some form of equalisation could then ensue.

Second, Mr Aznar's war against ETA has left it severely weakened. Whether this makes it more or less intransigent is open to debate, but the moment is opportune for it to declare a ceasefire. Terror, as a weapon, has never been more unpopular in Spain. Moreover, the new government is more flexible than its predecessor, though it too is sternly opposed to anything to do with ETA: it went to court last month to prevent Herritarren Zerrenda from contesting the European elections, successfully arguing that this new party was Batasuna in a different guise.

Third, ETA's campaign of murder and intimidation has had a much bigger effect on the Basque country than is commonly realised. To watch the promenaders strolling by the beach in San Sebastián on a spring evening makes this seem the most delightful of towns. The locals say that, whether in terms of health care or the quality of the roads, life in the Basque region is unmatched elsewhere in Spain. Yet, now that Northern Ireland is quieter, there is no other place in Europe where 40,000 officials, magistrates, businessmen, politicians and journalists live in fear of assassination. Perhaps 2,000 or 3,000 are judged to need bodyguards.

Fourth, however defined, nationalism is not going away. Though the combined vote for the conservatives and the Socialists has increased at every election over the past 15 years, from 65% of the total in 1979 to 80% in 2004, nationalists still control the Basque region, and their counterparts are gaining ground elsewhere. True, they have lost control in Catalonia, but the Socialists in charge there now are strongly regional in their outlook, and rule Catalonia in coalition with a nationalist group whose parliamentary strength increased from one to eight in the March election.

So Mr Zapatero is in hock to the Catalan Socialists, who are in turn in hock to a bunch of fiery left-wing nationalists. Even if he were inclined to do nothing, he would find the pressure difficult to resist. As it is, he is committed to some minor but sensible changes to the Senate, reform of certain statutes and a role for the regions in some EU deliberations. But he knows this is awkward stuff which could prove time-consuming in parliament.

All the signs are that Mr Zapatero will give as little as possible to the Basques. He shows no sign of yielding in his opposition to the Ibarretxe plan, and Juan Fernando López Aguilar, his bright young justice

minister, says firmly, “The Socialist Party will never accept self-determination for any part of Spain.” The Socialists point out that constitutional change needs the agreement of other parties, including the PP.

Why not call their bluff?

In time, though, it would be refreshing to see a Spanish prime minister challenging the nationalists to face the consequences of their demands. Instead of flatly ruling out self-determination on constitutional grounds, he could say, “All right, let's settle the terms on which you could secede and then we'll see whether you really want to do it.” Something like this lay behind the Clarity Act that Canada passed in 2000 to deal with Quebec's constant demands for “sovereignty”. It helped there, and could help in Spain. Opinion polls suggest that barely a quarter of Basques are diehard secessionists; a study by the BBVA, the big local bank, suggests they would be much less well off on their own. And the Catalans clearly have no wish to depart.

On the other hand, many people in the regions have a completely understandable desire to be ruled with a more sensitive hand from Madrid, to promote their language and culture and to enjoy a degree of self-rule. And if, perchance, one day the Basques, say, did vote to peel off, would it be the end of the world? Who wants to keep captive within their borders a people who want to leave?

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The prizes in store

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Mr Zapatero has the chance to take Spain into a new era of harmony and prosperity

IT WAS a British Conservative, John Major, who came to power in 1990 saying he wanted to build “a country that is at ease with itself, a country that is confident, a country...willing to make...changes”. Mr Major was largely talking about ridding Britain of its class system, not a big problem for Spain, but his words might well serve for a Spanish Socialist today.

The central cause of Spain's absence of ease is the civil war and the long period of Francoism after it. As Paloma Aguilar, of UNED, Spain's “open” university, has written, by 1975 Spanish society had managed to reach agreement, not on an uncontested account of what happened during the civil war, but at least on some lessons to be drawn from it. The main one was that the two warring sides were equally responsible for the barbarism, and neither bore more guilt than the other. The episode was simply the result of “collective madness”.

This general understanding—an understanding, if you like, not to stir too disruptively—made possible, first, the Moncloa pacts between the party leaders during the transition, which established some agreed rules of political engagement. More lastingly, it made possible the success that Spain has enjoyed on almost every front during the past 30 years.

The understanding did not, however, exorcise all the ghosts of Franco, or all the legacies of his regime. It left a Catholic church rather too closely tied to the state for an increasingly secular country with a grim, if distant, history of religious persecution. And it left a conservative party rather too authoritarian for a modern democracy, for, though Mr Aznar did much to make the PP respectable, he did nothing to broaden debate within the party. He knew he could not lead it for more than two terms, but he did not report back, did not trust his lieutenants, especially in the foreign ministry, and did little to encourage the development of internal expertise. Neither did he give the PP a democratic structure. He chose his own successor.

The agreement not to look back, or not too closely anyway, also led to a rather curious consensus. This was not a consensus of the post-war Italian kind, in which government was undertaken jointly by all the “respectable” parties in coalition amid a general sharing of the spoils. In Spain, the consensus changed with the government. It meant that when the PP was in power, the done thing was to support it, to defer to it and to seek its approval. When the Socialists took over, though, a remarkable switch took place: suddenly it became fashionable, as it is now, to declare support for the new government, to flatter it and to revile the outgoing lot.

It is a pattern of excessive deference, followed by excessive rejection, if not humiliation. Thus, on leaving office, Adolfo Suárez, Spain's first post-Franco prime minister, was likened to a Mississippi card sharp; Mr González, the third prime minister, was abused in public and dared not visit universities for fear of attack; and now there is talk of Mr Aznar being taken to court for war crimes.

Franco's legacy is seen even more clearly in the unease caused by nationalism. Spain would have had regional demands of some kind without Franco. But it is revealing that the nationalism in the three Basque provinces of France is very much less troublesome than the nationalism in the four Basque provinces of Spain. Franco's attempts to suppress the non-Castilian elements of Spanish culture led to the bitterness, as well as the vigour, that accompanied their resurgence.

Magnum

The ghosts live on

Mr Aznar made matters worse by behaving like a Margaret Thatcher when there was no need of one. Spain had a political-cum-security problem with ETA, much as Britain had with the IRA, but Spain had no vested interests like Britain's trade unions to face down. In any event, Basques and Catalans now feel unnecessarily slighted, and at the same time the nationalists among them have bred a tiresome victim mentality in their regions.

Getting there

What can Mr Zapatero's government do to put matters right? It has, on the whole, made a good start. It has embarked on some overdue social reforms, concerning divorce, abortion, gay marriage, domestic violence and other women's issues. (Mr Zapatero is clearly in earnest when he calls himself a feminist: half his cabinet are women, and he is ready to change the constitution to allow a woman to ascend the throne.) These measures will win the government some friends and make it no enemies outside the Catholic church, and even the church is shifting on some issues.

Some other reforms are less certain, but would be just as desirable: stricter corporate governance, a stronger competition court, an end to the pro-government bias in parliamentary committees and the depoliticisation of Spain's large companies. All these would reduce the power of politicians and increase the independence of other institutions.

Next comes a real test: public broadcasting. Radio Televisión Española, especially its television news, is by common consent a disgrace, a government mouthpiece that would not be out of place in a banana republic of yore. Governments, including Socialist ones, have vowed to reform it before, only to find that a government mouthpiece can be very useful at times. Mr Zapatero says he will do better. He has appointed an academic widely seen as independent, Carmen Caffarel, as director-general. And he has set up a committee of “wise personages” to make recommendations for a truly independent service along the lines of the BBC. Hopes are high for real change this time.

Feedstock for the future

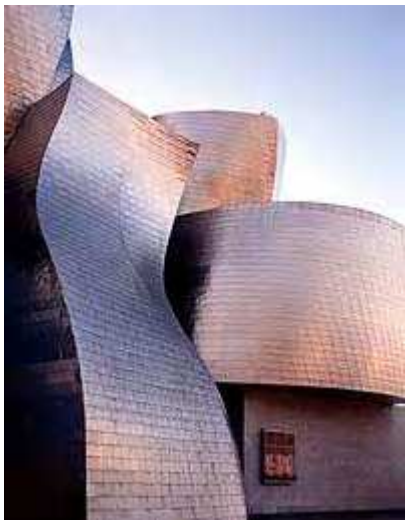
His next task should be to shake up the education system, especially the universities. Spain has opted for a huge expansion in the number of its universities, two-thirds of which have been created since 1975, but this has done little to improve either the quality of teaching or the students' independence of thought. Standards are low, and the system produces too many lawyers, too few scientists.

There are a few good private universities, especially in Catalonia and Navarre, and one or two good business schools such as IESE's two campuses in Barcelona and Madrid, but too many students hang around, often for six or eight years, doing courses that would be completed in three or four elsewhere. Few are thrown out for failing exams; they just take them again and again until they pass. As for the teachers, they are usually recruited from within the university, often for life, and have little experience of the outside world. The upshot, says Víctor Pérez-Díaz, a sociologist who has taught at Harvard and the University of California as well as Madrid's Complutense University, is a body of uninquiring students who cannot write, set priorities or elaborate an argument.

Then comes the issue of nationalism. Mr Zapatero is much less abrasive

than Mr Aznar, and he has the advantage not only of being a new face himself, but also of dealing with several new faces in the regions. Yet nationalism excites strong passions and he may still find the going hard, particularly if he allows the impression to take hold that he is seeking “a solution to the problem”. This would be a mistake.

Alamy



A glint of the new Spain

The best he can hope to do is to manage nationalism. It can be managed well or it can be managed badly, but it cannot be solved. That is because it is not a problem, and indeed one way to ensure a bad outcome is to think of it as such. Better by far to see it as a blessing—a blessing that gives Spain variety, cultural vitality and internal competition of the best kind, allowing innovation and experimentation.

Recognition of this comes cheap and is likely to yield rich rewards. It would reinforce the strength of Spain as a country that is considerably greater than the sum of its parts. It would also do much to relieve the country's internal tensions and make it more at ease with itself. It would give it confidence. If this could be combined with changes in behaviour and attitudes, as well as institutions, to build greater independence of spirit, then the Zapatero government could be seen as the one that marked the start of the second transition, when the ghosts of the civil war and Francoism could finally be put to rest. Spain could even try to find a more plausible reason for the civil war than simple “collective madness”.

Mr Zapatero could aim for even more. With a series of liberalising economic reforms, the ones that Mr Aznar failed to make in his second term, his government could launch Spain on another period of economic growth that might see it overtaking Britain and Italy in terms of income per person. Spain has most of the necessary ingredients—effective government, sound finances and a potentially strong business sector. It has shown on at least three occasions that it can overcome difficult economic circumstances: in 1975-77, when a country without even a democratic constitution suffered a serious oil shock; in 1982, when, after an attempted coup a year earlier, an untested Socialist government faced another deep economic crisis; and in 1992-93, when the peseta was struggling to stay in the EU's exchange-rate mechanism.

If Mr Zapatero can provide the right leadership, Spain can bound forward again. *Zapatero, a tus zapatos.* Let the cobbler stick to his last.

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The Elcano Royal Institute publishes many valuable reports, some of which are available in both Spanish and English.

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Technology, shopping and beyond

The future is still smart

Jun 24th 2004 | LONDON AND NEW YORK
From The Economist print edition

Contrary to some recent reports, the roll-out of revolutionary smart-tag technology is still going to plan

SO THOROUGHLY have the lessons of the internet bubble been learned that the launch of any new technology is now invariably accompanied by much talk from industry observers about dangerous hype and inevitable disappointment. A case in point is radio frequency identification (RFID), a new, super-cheap version of which may, its backers hope, be destined to transform everything from shopping to warfare. As soon as RFID's boosters alerted the world to their innovations, reports of dire setbacks began to circulate. Yet if anything, the surprise is how well the roll-out of the new technology is meeting early expectations.

RFID systems are made up of readers and “smart tags”—tiny microchips each with an attached antenna. The tags can be stuck on everything from milk cartons to hospital patients. When prompted by a reader, the tag broadcasts the information on its chip. Unlike the traditional bar-code, which smart tags aim to replace, RFID chips give every tagged object a unique identification. (A bar-code describes only a class of objects, such as cans of Coke.) Companies hope to use RFID to track the trillions of objects that circulate the world every year in planes, lorries and ships, through ports and warehouses, on to shop shelves, through tills and into homes and offices. Accurate tracking should eventually save hundreds of billions of dollars a year as it improves distribution, reduces theft, cuts labour costs and shrinks inventory. Governments also want to use RFID to reduce drug counterfeiting and improve military logistics, among other things.

Smarter than the average bar-code

Firms have put smart tags on some goods for quite a while. But due to their cost tags have until recently mostly been stuck on expensive or oft-stolen items, such as designer clothes and compact discs.

In 2002, the Auto-ID centre, a partnership between academic researchers and business based in Cambridge, Massachusetts, came up with a standard for a new, stripped-down RFID chip that stores just 96 bits of information—enough to give every object in the world a unique number. With tag readers plugged into a computer network, this number can be used to look up detailed information about the object, such as its origin, age and expiry date. At the same time, the Auto-ID centre also challenged manufacturers to produce a five-cent tag. Several start-ups, including Alien Technology and Matrics, said they could do so. Suddenly, there was huge interest and talk of a potential mass market.

Last June, Wal-Mart, the world's biggest retailer, said it would require its 100 top suppliers to put tags on pallets and cases of products for shipment to a cluster of its supercentres in northern Texas. (Those press-ganged suppliers were later joined by 37 “volunteers”.) Tesco, Britain's biggest retailer, also

decided to introduce the technology. This year Metro, a German retailer, and Target and Albertsons, two other American ones, announced tag mandates for their suppliers. On June 17th, Wal-Mart said it would extend its RFID roll-out to its top 300 suppliers and to more shops.

The American government is becoming a big user of the new tags, too. Last October, the Pentagon said it would require its suppliers to put tags on cases and pallets shipped to its warehouses. It expects suppliers to have the technology working by January. The Food and Drug Administration wants drug manufacturers, distributors and retailers to adopt the new RFID technology to combat counterfeiting.

Alien Technology says that its current production line can assemble 2m chips a month. By the end of this year, it will have a second-generation line, able to assemble 2 billion chips a year. By 2006, it plans to introduce two third-generation production lines, each able to assemble ten billion chips a year. For orders of 1m, Alien Technology now sells its tags for 20 cents each. When the third-generation arrives, says Tom Pound of Alien Technology, “we believe that our best customers will be able to order finished tags for prices approaching five cents.” Established manufacturers, such as Texas Instruments and Philips, are also entering the market.

So why all the gloom? Much of it stems from suppliers who feel they are being forced to pay for an investment that saves retailers money. Wal-Mart, for instance, is using tags to track goods from when they leave suppliers, through its warehouses, docking doors and supercentre stock rooms, to when they leave the back rooms for the supermarket shelves. Even more gallingly, the only time suppliers are likely to hear from Wal-Mart is when they make mistakes. At least the Pentagon, which last year sent a delegation to Wal-Mart's headquarters in Bentonville, Arkansas, to learn about RFID, plans to pay for its own tags.

Another problem is that the industry does not yet have a single hardware standard. The work of the Auto-ID centre produced two competing tag standards. EPCglobal, one of the successor bodies to the Auto-ID centre, is now working on a single superseding second-generation standard. Within EPCglobal four warring factions of manufacturers recently shrank to two. EPCglobal has promised to deliver the new standard by the end of this month, which should spur investment.

As investment rises, prices should fall further. Meanwhile, many firms hope that item-level tagging will soon make sense, particularly in Europe, where more efficient supply chains mean that there is less scope to reduce costs by other means.

Marks & Spencer, a British retailer, has just extended a trial in which tags are applied to suits, shirts and ties for men. The advantage of such item-level tagging is that it allows retailers to monitor stock levels with far more accuracy, and to order replacement goods at the end of each day to make sure that every size, style and colour remains in stock. Beyond improving efficiencies, retailers hope that smart tags could help to drive sales. James Stafford, head of RFID at Marks & Spencer, gives one example: a customer could take a tagged suit to a kiosk, which could then suggest a matching shirt and tie. Mr Stafford points out that men often lack confidence when shopping for clothes and would welcome advice, but are reluctant to ask for help.

But firms will have to handle privacy issues delicately. Scaremongering by some privacy advocates, who fear that details of everything they buy will be held on a database and potentially used for nefarious purposes, has made some firms quite defensive about their RFID ambitions.

Yet the ambitions mostly remain, and are increasingly becoming reality. Star City, an Australian casino, is already using smart tags to cut the cost of cleaning the 80,000 uniforms worn by its staff. The emergency room at the Shelby County Regional Medical Centre in Memphis, Tennessee, uses them to keep track of patients. Las Vegas airport is using tags to track luggage better, to reduce the number of items that get lost and to improve security.

As prices fall, demand should continue to grow, from tens of billions of tags in 2006, to hundreds of billions by 2009, to perhaps trillions a few years later. As prices fall to a fraction of a cent, most organisations dealing with physical logistical challenges should find valuable uses for the new tags. Some may one day even thank Wal-Mart for introducing them.

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Wal-Mart

Trial by checkout

Jun 24th 2004
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Facing a giant sex-discrimination suit

Bloomberg News

How may I promote you?

THE world's biggest retailer is used to dealing with big numbers, but even Wal-Mart does not want to end up having to defend the world's largest civil-rights lawsuit, which, on June 22nd, a federal judge in San Francisco decided can proceed against the company. Having earned a $9 billion profit on $256 billion of sales last year, it is not so much the prospect of a big payout that worries Wal-Mart, but that the suit would deliver yet another blow to its already battered public image.

Wal-Mart says that it will appeal against the ruling, which allows up to 1.6m past and present female employees in America to take part in a class action. This alleges that Wal-Mart discriminated against them in pay, promotion and training. The retailer, famous for driving down costs, argued that its devolved management style meant that most employment decisions were made locally at its more than 3,500 stores in America, and so cases should be dealt with individually rather than as a class.

Even so, Judge Martin Jenkins said that it was possible for a corporate culture to permeate through an organisation and result in discrimination. His ruling was not about the merits of the case, yet simply allowing it to proceed as a class action may mean that Wal-Mart makes big concessions, not least to avoid a trial that could drag on for years and generate streams of embarrassing headlines.

The case, originally brought by six women, claims that Wal-Mart routinely puts women into jobs with little chance of promotion. Their lawyers say that women make up two-thirds of Wal-Mart's paid-by-the-hour employees, only one-third of whom ever become salaried managers. One woman claims to have been told that to qualify as a manager she had to be able to stack giant bags of dog food.

Wal-Mart has long argued that its female employees are fairly paid, and says that the reason for any under-representation is that they do not apply for promotion as often as men. It faces other lawsuits alleging that staff are overworked and underpaid, and is awaiting a federal grand-jury investigation into allegations that it knowingly used contract cleaners who hired illegal immigrants. The company recently put in place a new compliance team and launched a massive public-relations campaign to show that it supports minorities and local communities, some of which have tried to prevent Wal-Mart moving into their area.

If Wal-Mart loses its appeal, will it try to settle out of court? That would be costly: a class action for discrimination brought by 25,000 women against Home Depot led that firm to take a $104m settlement

charge in 1997. On that basis, Wal-Mart's bill could be several billion. Wal-Mart has hitherto taken a hard line on what its bosses view as nuisance lawsuits. But it is said that inside the firm proponents of taking a softer approach are gaining ground. A trial could further alienate consumers, especially women, and lead to a backlash against the firm. Significantly, Wal-Mart's boss has gone out of his way to demonstrate his determination not to let the discrimination charges stick. He has set targets to increase employment diversity at the firm, and given warning that executives will forfeit part of their bonuses if these are not met.

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The Hollinger affair

The twins win

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The Barclay twins win the Telegraph, unless Conrad Black stops them

WHY Britain's most reclusive businessmen want the publicity that owning a famous newspaper brings is a mystery. But the Barclay twins wanted Britain's *Daily Telegraph* so badly that, after failing to get it earlier this year, they eventually agreed to pay the sort of price—£665m ($1.2 billion)—that only a trophy asset can attract. They outbid 3i and Veronis Suhler Stevenson, a team of two private-equity firms motivated mainly by the paper's ability to make money. The Barclays are being hailed as heroes at the Telegraph Group, where many feared that a private-equity owner would slash costs, or that Richard Desmond, owner of the *Express* and other tabloid papers, might triumph.

Five months ago Sir David and Sir Frederick Barclay shocked rivals by agreeing to pay Conrad Black $465m for his stake in Hollinger Inc, a holding company that owns 30% of the shares and 72% of the voting rights of Hollinger International, which owns the *Daily Telegraph*. But Hollinger International persuaded Leo Strine, a judge in Delaware, to block the sale. Now, ironically, only Lord Black himself can prevent the Barclays from buying the paper. The law in Delaware, where Hollinger International is incorporated, requires shareholder approval for transactions where “substantially all” of a firm's assets are to be sold. Judge Strine said this month that the issue may have to be decided in court.

At stake is how much cash Lord Black walks away with. Under the original deal he would have kept roughly $405m, with $60m set aside in escrow by the Barclays to cover liabilities arising from various lawsuits against Hollinger Inc—which, along with Lord Black and his associates, is accused of wrongly taking money from Hollinger International. Under the new deal, the Barclays' money will go first to Hollinger International, which is expected to pass on a good deal of it to shareholders. As the firm is suing Lord Black and his associates for $1.25 billion on racketeering charges, it may try to withhold his share of the cash. So Lord Black is likely to try to block the deal—or at least use that threat to extract some money.

Beyond selling the *Daily Telegraph*, Hollinger International still has to deal with its board of directors, which includes Henry Kissinger and Richard Perle, former chairman of the Pentagon's defence policy board. Last week, Tweedy, Browne, an activist shareholder whose concerns triggered the investigation at Hollinger International, complained that the firm's special investigating committee seems to lack the will to pursue the firm's board and KPMG, its auditor. Another shareholder is optimistic that the committee will turn its attention to the board in due time.

Hollinger must also decide what to do with the rest of its assets, including the *Jerusalem Post*, scores of regional Illinois papers and the *Chicago Sun-Times*. It recently announced that the *Chicago Sun-Times* has been inflating its circulation figures, which may put off potential buyers.

For the Barclays, a pressing task will be to negotiate with Mr Desmond, half-owner of the *Daily Telegraph*'s main printing plant outside London. He has the right to buy the other half from the newspaper if it changes hands. Another decision will be whether to launch a tabloid edition, as the *Independent* and the *Times* have done—currently, Telegraph Group managers are inclined not to. Three years ago the *Daily Telegraph* sold over 1m copies a day, but it has the oldest readers of any British paper and circulation has since fallen to around 900,000. The Barclay twins may have won the bid, but can they stop the rot?

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Corporate scandal in France

Getting Messier

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From The Economist print edition

The continuing pursuit of a disgraced boss

Get article background

JEAN-MARIE MESSIER, the disgraced former boss of Vivendi Universal, a media and telecoms group that fell from grace in 2002, is facing further dishonour. He was placed under formal investigation on June 23rd after two days in police custody and four hours of questioning by Henri Pons and René Cros, examining magistrates. He was discharged on bail of €1.35m ($1.6m).

Mr Messier hopes to revive his reputation at the trial that seems certain to follow the investigation. According to Olivier Metzner, his lawyer, since March he has asked to be formally investigated and has a big dossier that he hopes will bolster his defence.

Admittedly somewhat belatedly, the French market watchdog is thought to be lining up accusations against Mr Messier that are similar to those already brought by America's Securities and Exchange Commission (SEC). Mr Messier settled with the SEC in December last year by paying a $1m fine, giving up any claims on a $26m severance package from Vivendi and agreeing to be barred from holding directorships of quoted American companies. The SEC accused him of lying to investors about the company's financial health. Mr Messier, for instance, allegedly authorised consecutive financial statements in 2001 that inflated Vivendi's profits.

Magistrates are also looking at the buyback of some 21m Vivendi shares worth about €1 billion in the weeks after the September 11th attacks that year. French market rules forbid share buybacks that exceed 25% of average trading volume, and also outlaw massive shopping sprees during the last five minutes of a trading day. Vivendi allegedly infringed both rules, instructed to do so by Mr Messier.

The Commission des Opérations de Bourse (COB), as the market watchdog was called then, was apparently aware of the irregular buybacks, but chose to ignore them. On October 26th 2001 Michel Prada, boss of the COB, wrote to Mr Messier saying that while the share buybacks exceeded normal limits he would not investigate them because of the exceptional market circumstances. According to Didier Cornardeau, head of APPAC, an organisation of small shareholders, the COB was either an accomplice of Mr Messier or incompetent.

America's disgraced bosses are now being vigorously pursued by America's justice system. Whether the French legal system, which has traditionally tended to treat important folk gently, will now follow in America's footsteps, Mr Messier, who in his pomp loved to describe himself as a French champion of American-style capitalism, may soon find out.

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Halliburton

The heat is on

Jun 24th 2004
From The Economist print edition

Welcome to Halliburton Cheney Week

AP

His unseen hand is the problem

"WE GET beaten up every day, and this is going to go on until the November election. In fact, the Democrats even say this is Halliburton Cheney Week!" So says David Lesar, boss of Halliburton, an energy and engineering-services company that has received an extraordinary amount of negative publicity since the start of the war in Iraq. Yet Mr Lesar remains unbowed: "We are a big, tough company and we can stand the heat."

Not least because America's vice-president, Dick Cheney, used to run the firm, its Kellogg Brown and Root (KBR) division has been dogged by allegations of favouritism. One of the loudest voices belongs to Henry Waxman, a Democratic Congressman who is conducting hearings on the matter. And as some of the work in Iraq was awarded to KBR on a "cost-plus" basis, other critics accuse the firm of fleecing taxpayers. One raging controversy has concerned the number and cost of meals served by Halliburton to soldiers. Pentagon auditors are unhappy, and last week declared that KBR may have charged taxpayers for 36% more meals than it actually served. The firm insists that the figure is much lower, and says that the uncertainties of war help explain any discrepancy.

Given all this fuss, you might think that Halliburton had hit the jackpot. After all, its former chairman sits in the White House allegedly slipping it cost-plus contracts. The revenues of its engineering and reconstruction arm, which includes KBR, soared by nearly $3.5 billion last year to $9 billion (out of total revenues of $16 billion) thanks mostly to work in Iraq. The firm's two contracts in that country—to provide logistical support and to rebuild oil infrastructure—could eventually bring KBR over $18 billion in revenues.

Yet while the rest of Halliburton increased operating profits in 2003 by nearly $200m to $826m, the engineering division actually posted an operating loss of $36m. The Pentagon is not a fast-paying customer. KBR and other contractors in Iraq must perform services before claiming reimbursement. In the first quarter of this year, Halliburton said that some $1.25 billion it was due for work done in Iraq had yet to be paid by the Pentagon; those arrears were up from $880m three months earlier. When there is controversy over billing, defence officials can withhold payment. For instance, in a dispute unrelated to the meals scandal, they are threatening to withhold, from August, some 15% of the payments due to KBR.

Besides, KBR is a labour-intensive, low-margin business, in contrast to Halliburton's oil-field services arm, which arguably leads its industry. And it exposes employees to great danger: of over 30,000 working for Halliburton and its subcontractors in Iraq, 41 have been killed.

Indeed, KBR may well be weighing on Halliburton's share price. The political controversy around Mr Cheney's role may have made investors nervous. Certainly, since Mr Cheney took up political office Halliburton's shares have underperformed those of many of its peers.

Nor is the controversy limited to Mr Cheney and Iraq. Investigators from France, America and Nigeria have suggested that a natural-gas project consortium involving KBR may have bribed local officials in Nigeria. On June 18th, Halliburton formally severed links with Albert "Jack" Stanley, a consultant and

former head of KBR, citing “improper benefits” that he received. Some investors fear that more bad news may follow.

So why not sell off KBR, and set free the shareholder value trapped in Halliburton's vibrant oil-services division? Perhaps surprisingly, Mr Lesar, who has spent countless hours defending KBR, says that he is “open” to the idea. But, he explains, he cannot act just now, because a part of KBR that is exposed to asbestos liability has declared bankruptcy. By the autumn, he predicts, the uncertainty over asbestos will be gone and his firm might be more attractive to investors. He is convinced that the hefty discount on Halliburton shares will fade. If KBR is indeed sold, he will have found a permanent way of dealing with the heat now scorching Halliburton: by getting out of the kitchen.

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South African privatisation

On hold?

Jun 24th 2004 | JOHANNESBURG
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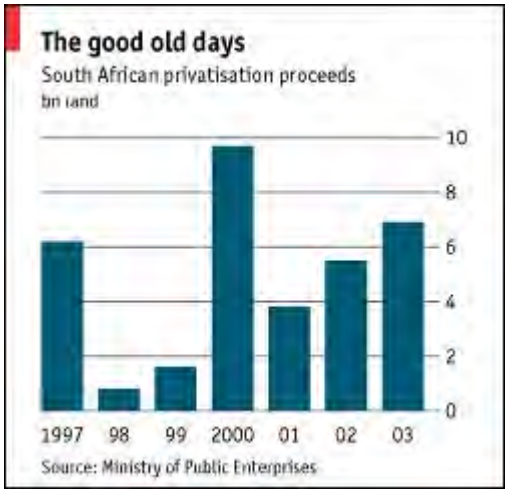
There is growing uncertainty about South Africa's privatisation plans



HOW much does South Africa want foreign investment? Not much, judging by two recent signals sent by its government. First, on June 14th, Alec Erwin, minister of public enterprises, told parliament that he had no plans to sell off any of the large state-owned companies that have long been destined for privatisation. Then Thoko Didiza, minister of agriculture and land affairs, touted the idea that foreigners should not be allowed to buy land in South Africa because they are pushing local property prices up too high.

Mr Erwin's comments probably matter more. He still thinks that some of South Africa's baffling collection of small state-owned firms might be sold in the next year or two, including the luxury tourist "Blue train", some forestry operations, a firm that runs airports, and a long-haul bus company. But anything of serious value will be held back. South African Airways, the national airline, will not be sold, he says, because market conditions are wrong and, anyway, it is too indebted. Eskom, a booming energy supplier with fast-expanding operations all over Africa, would be of great interest to buyers. But along with Denel, an armsmaker, and the post office, the most that Mr Erwin ever envisages selling, some day, is a 30% stake to a single private partner.

Since 1997 the sale of state-owned assets has raised 34 billion rand ($5.3 billion), but national budgets until 2006 now predict revenue of only about 2.5 billion rand a year. Even that may not be achieved. Mr Erwin says he prefers to make state-owned firms work better first, not to preside over "some sell-off type of privatisation".

State-owned or not, he will struggle to get them in better shape without exposing them to competition. Customers—including your correspondent—are fuming about repeated power cuts in Johannesburg as Eskom has failed to cope with a spell of cold weather. A recent report noted that Telkom, the monopoly land-line phone company (which was mostly privatised last year), charges its customers among the highest prices in the world. After years of dithering the government has still not granted a licence for a second national phone operator.

Mr Erwin says that he will think further about privatisation before publishing a more complete plan later this year. But Mrs Didiza's proposal on land would be best forgotten entirely. Her suggestion that foreigners only be allowed to lease land risks scaring away investors from the country's blossoming tourism industry, where many foreigners have been buying guest-houses, hotels, vineyards and safari parks. Other investors who already use South Africa as a base from which to export high-value fruit, vegetables and flowers to European and other markets could be put off too. South Africa's politicians constantly lament that their country gets too little foreign investment. But by refusing to sell what outsiders want, and by seeking to block them from other purchases, the ministers are telling outsiders to stay away.

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Japan's technology secrets

Protecting the family jewels

Jun 24th 2004 | TOKYO
From The Economist print edition

As Asian economies integrate, Japanese firms are struggling to keep their secrets

AT ONE Japanese electronics firm, executives refer to a pair of big rivals as “new S” and “old S”. The latter refers to Sony, the electronics and media giant that once epitomised the strengths of Japan's gadget-makers. The “new S” is Samsung Electronics, a South Korean firm that innovates faster than a speeding bullet and leaps whole generations of technology in one bound. At times, such as when Sony went crawling to it last year for help to make liquid-crystal displays (LCDs), South Korea's tech giant seems on its way to invincibility.

Yet although the advances made by Samsung and its South Korean rival, LG Electronics, are impressive, they relate to a narrow set of activities compared with Japan's wide-ranging strengths. Samsung has achieved most of its success in just three areas. It makes a handful of world-class consumer-electronics devices, such as mobile phones; it is a leader in the semiconductor industry; and it is at the forefront of technology for producing LCDs.

Samsung's technological prowess and marketing savvy have made it a fierce new rival to Japan's established consumer-electronics giants. But while firms such as Sony, Sharp and Matsushita have long received most of the publicity, Japan also boasts dominant firms in several sprawling sub-sectors, without which the global electronics industry could not exist.

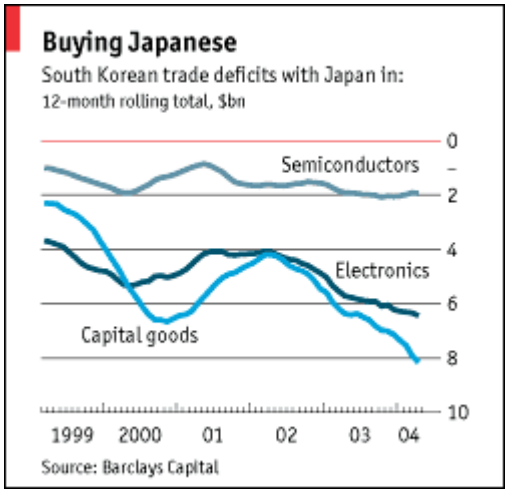
This includes a range of precision-equipment firms, such as Canon and Tokyo Electron, which make the expensive machinery that Samsung and its rivals use to produce chips. It includes firms such as Kyocera and Murata, which make ceramics and fine materials essential to digital devices. And it includes firms, and divisions of some big firms, that make electronic components that snap into such gadgets as mobile phones and digital cameras. Nidec, for example, dominates the global market for tiny motors that power devices such as hard drives and DVD players. These firms tend to have only a couple of serious rivals (many of them also Japanese), and are making bumper profits selling to firms in Japan and the rest of Asia.

Trade flows within north-east Asia hint at how essential some of this technology still is. South Korea has a trade surplus with China, but it coincides with a widening deficit versus Japan (see chart). This includes not only a slight deficit in semiconductors, but also bigger shortfalls in both high-value electronic components and capital goods (a category which includes the precision equipment that goes into making chips and LCDs). These are the inputs that South Korean firms must buy to produce the limited range of electronics devices at which they excel. Sony may need Samsung to make the LCDs for its televisions, but Samsung needs expensive equipment and materials from a whole host of sophisticated Japanese firms in order to crank out those panels.

For much of Japan's electronics industry, the biggest challenge nowadays is not so much Asian competition per se, but rather the interaction between stiffer competition and regional integration. As the firms making electronic components, precision equipment and fine materials try to compete by moving production to low-cost China, they must somehow stop their secret manufacturing processes leaking to local employees. In Japan's Kansai region, where many of the firms in these sub-sectors are based, technology managers have become obsessed with this problem.

Japanese firms supplanted American rivals in the 1970s and 1980s by devising better ways to make electronic devices that had been

invented elsewhere. Although Japan's engineers could famously take apart an American gadget and reverse-engineer its design, it was much harder for non-Japanese firms to copy Japan's innovations. These were embedded in advanced-manufacturing processes that, unlike a physical device, could not be prised open and studied by would-be imitators. But increasingly the rapid spread of manufacturing to South Korea, Taiwan and China threatens to expose these secrets.



No wonder Kyocera, which makes semiconductor materials and electronic components, produces its most complex materials in Japan, and does simpler processes in other Asian countries. Tatsumi Maeda, a Kyocera technology and strategy manager, describes the extraordinary lengths that his firm goes to when manufacturing in another country. Workers in its overseas plants are told precisely how to mix materials from Japan with local ones, but are given no idea what the ingredients are. When a part breaks on an advanced machine overseas, Kyocera's Japanese engineers disassemble and repair it in privacy, so that none of the local workers can take a good look.

In some cases, Japanese firms even sacrifice some short-run economic gain, safeguarding their secrets by using humans where machines and software would be more efficient. Sharp, for instance, fears that suppliers will export its hard-won manufacturing know-how along with their capital equipment. So it explicitly designs gaps into the automated processes at its advanced LCD factory in Kameyama, Japan. The right moment to twist a knob or push a button is thus kept safely inside the heads of a few Sharp employees.

As Japanese technology firms build ever more factories in China, or export their materials and equipment to firms that do, they will struggle to protect these sorts of secrets. Jealously guarding what they call their “black box” will make it hard to foster loyalty and continuity in their Chinese factories. And they will face an additional challenge as loyalty begins to erode among their domestic employees. An R&D manager in Kyoto complains that a big South Korean firm—no prize for guessing its first letter—has been in the area trying to poach engineers from his company and its local rivals. As Asia's technology battles heat up, the most important “S” of all still stands for “secrecy”.

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Face value

Growth stocks, anyone?

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Steven Scheid, Gary Black and the uncertain future of America's mutual funds

IT HAS been a long, strange trip for America's giant mutual-fund industry. Only four years ago, fund managers were dizzy with success as retail investors poured money into so-called “growth funds” that bought telecoms, media and technology shares ranging from Amazon.com to WorldCom. One fund manager associated more than any other with growth stocks, now known as Janus Capital Group, received over half of all the money invested in American equity mutual funds in 2000.

Since then, the industry has had nothing to celebrate. The bursting of the stockmarket bubble shocked many investors into extreme risk-aversion. Then last year, just as share prices were recovering, the mutual-fund industry was further discredited by a winter of scandal. Regulators have so far charged 19 mutual-fund companies with misdeeds such as giving undisclosed favours to rich clients or misusing their relationship with brokers. The industry has been deluged with new regulations, the latest announced this week (see article).

Having risen highest during the bull market, Janus has since fallen as hard as anyone. First it suffered huge withdrawals by investors. Then it saw Tom Bailey, its legendary founder, depart. Finally, completing a long, debilitating escape from its ownership by Kansas City Southern, a railway firm, Janus went public in January 2003—only to get a dismal reception. Then the regulators struck. This April, Janus paid $226m in fines and investor compensation to settle charges of unethical trading. Regulators, including Eliot Spitzer, New York's attorney-general, had accused Janus of “market timing”—letting favoured clients move rapidly in and out of Janus's funds, creating trading costs borne by all investors. (Perhaps, after the bubble burst, it did this in a bid to retain those clients' assets.) Janus's assets under management are down from $330 billion in 2000 to $136 billion now.

The market-timing scandal coincided with more change at the top, as Mark Whiston, chief executive since December 2002, left. Fittingly for a firm named after a two-faced Roman god, the job of reviving Janus has been taken on by a leadership duo: Steven Scheid (pictured left), the chief executive, and Gary Black (right), the chief investment officer. This echoes the team of Mr Bailey and James Craig that led Janus to its former triumphs. But the similarities stop there. Strikingly for a firm that has long prided itself on the quality and loyalty of its people, both new bosses are outsiders: Mr Scheid made his name at Charles Schwab, a mutual-fund firm and brokerage, and Mr Black at Goldman Sachs, an investment bank, and, earlier, Sanford Bernstein, a research firm. “We're setting a completely different tone at the top in this company,” declares Mr Scheid—who, to prove it, has accepted a pay package one-third less than his predecessor's.

The firm, which has its main operations in Denver, Colorado, used to stress its staff's similarities to the good sort of cowboys who ventured forth fearlessly to develop the potential of the American west—in Janus's case, Silicon Valley. Now, cowboy culture conjures up a less appealing image (there are more than 60 class-action lawsuits pending against Janus). Whilst neither Schwab nor Goldman have unblemished records, if the new men can effectively integrate the best bits of those two firms' cultures into the useful bits that remain of Janus's own—a big if—there should be few future complaints from investors.

The pair will, no doubt, have been encouraged by recent evidence that retail investors are tentatively returning to equity mutual funds. According to Strategic Insight, a consultancy, in the past year or so flows have turned positive again, with a spike in January 2004 that exceeded even the bubble days. But most of the money is going to value and balanced funds. Investors are still switching to firms such as Vanguard, Capital Research and Fidelity that came through the scandals more or less clean and emphasise low costs as much as visionary investing.

About face?

This prompts a big strategic question. Certainly it is admirable that Mr Scheid spends half his time on the road, lobbying investors to give Janus a second chance and admitting the firm's past mistakes—quite a change from the close-mouthed and stand-offish attitude in the years after Janus went off the cliff. But wouldn't it be even better to abandon Janus's old focus on growth stocks in favour of a more balanced approach?

Mr Black, a former head of Goldman's asset-management arm's global-equities team, says he will stick with growth stocks, and insists that Janus's portfolio managers—many of whom remain from happier days—have learned self-discipline. (Janus managers never worried much about what price they paid for a good prospect.) But Mr Black made his name on Wall Street in 1993 with a brave contrarian call on the ultimate non-growth stock, issuing a “sell” rating on Philip Morris shortly before the price-slashing “Marlboro Friday”. Mr Scheid's old firm's crucial strategic move in the 1990s was to eschew association with a particular fund-management style and even its own funds by becoming a mutual-fund “supermarket” for investors. So both men are clearly willing to contemplate radical change.

Mr Black has already raised the number of firms followed by Janus analysts from 700 to nearly 1,000. That may make it easier to use an old mutual-fund trick of proclaiming a bold strategy—such as value or growth—whilst actually “closet indexing” the stockmarket. Yet, as some economists claim, the main reason why some mutual funds do better than others may be sheer luck. So maybe Messrs Scheid and Black should bet that now is, again, a time to be in growth stocks. Nearly three-quarters of Janus's funds are now rated in the top half for one-year performance by Lipper, a research firm, up from only 40% a year ago. Janus struck lucky with growth stocks before; why not again? Though perhaps this time it should get out a little sooner.

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About sponsorship

The future of advertising

The harder hard sell

Jun 24th 2004
From The Economist print edition

More people are rejecting traditional sales messages, presenting the ad industry with big challenges

IT MAY have been Lord Leverhulme, the British soap pioneer, Frank Woolworth, America's first discount-retailer, or John Wanamaker, the father of the department store; all are said to have complained that they knew half of their advertising budget was wasted, but didn't know which half. As advertising starts to climb out of its recent slump, the answer to their problem is easier to find as the real effects of advertising become more measurable. But that is exposing another, potentially more horrible truth, for the $1 trillion advertising and marketing industry: in some cases, it can be a lot more than half of the client's budget that is going down the drain.

The advertising industry is passing through one of the most disorienting periods in its history. This is due to a combination of long-term changes, such as the growing diversity of media, and the arrival of new technologies, notably the internet. Consumers have become better informed than ever before, with the result that some of the traditional methods of advertising and marketing simply no longer work.

Ad spending grew rapidly in the late 1990s, but in 2000—just as the technology bubble was about to burst—it soared by more than 8% in America, which represents about half the world market. The following year it plunged by 8%. Spending is up again, according to ZenithOptimedia, which has long tracked the industry. It forecasts that worldwide expenditure in 2004 on major media (newspapers, magazines, television, radio, cinema, outdoor and the internet) will grow by 4.7% to $343 billion. It will be helped by a collection of big events, including the European football championship, the Olympic Games and an election in America. Historically, when there is an upturn in advertising expenditure, it tends to rise faster than the wider economy. So, provided economic growth can be sustained, ad spending may continue to pick up.

How will the money be spent? There are plenty of alternatives to straightforward advertising, including a myriad of marketing and communications services, some of which are called “below-the-line” advertising. They range from public relations to direct mail, consumer promotions (such as coupons), in-store displays, business-to-business promotions (like paying a retailer for shelf-space), telemarketing, exhibitions, sponsoring events, product placements and more.

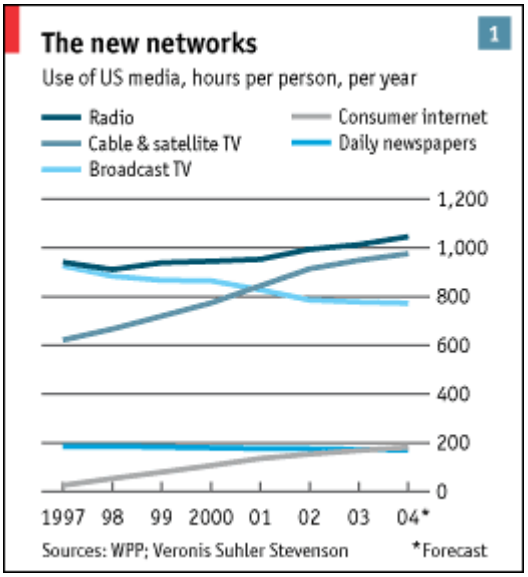
These have become such an inseparable part of the industry that big agencies now provide most of them. Although some are less than glamorous, marketing services have grown more quickly than advertising.

Add in the cost of market research, and this part of the industry was worth some $750 billion worldwide last year, estimates WPP, one of the world's biggest advertising and marketing groups.

As ever, the debate in the industry centres on the best way to achieve results. Is it more cost-effective, for instance, to employ a PR agency to invite a journalist out to lunch and persuade him to write about a product than to pay for a display ad in that journalist's newspaper? Should you launch a new car with glossy magazine ads, or—as some carmakers now do—simply park demonstration models in shopping malls and motorway service stations? And is it better to buy a series of ads on a specialist cable-TV channel or splurge $2.2m on a single 30-second commercial during this year's Super Bowl?

Such decisions are ever harder to make. Although a Super Bowl ad is still cheaper than in 2000, in general network-TV pricing has risen faster than inflation—even though fewer people tune in. Changes in TV-viewing habits, however, are only part of a much wider shift in the way media is consumed, not least because it has become more fragmented and diverse.

For a start, people are spending less time reading newspapers and magazines, but are going to the cinema more, listening to more radio and turning in ever-increasing numbers to a new medium, the internet (see chart 1).



After the technology bust it was easy to dismiss the internet. But the phenomenal success of many e-commerce firms, such as Amazon and eBay, shows that millions of people are becoming comfortable buying goods and services online. Many more are using the internet to research products, services and prices for purchases made offline. Some 70% of new-car buyers in America, for instance, use websites to determine which vehicle to buy—and often to obtain competing quotes from dealers.

Google that

Such consumers can be targeted by internet advertisers and, in some cases, their responses accurately measured. A surge in online advertising is being led by paid-for text-links dished up by search engines such as Google and Yahoo! The response rate from people clicking on paid links can be as low as 1%—about the same as direct mail, which remains one of the biggest forms of advertising. But there is an important difference: internet advertisers usually pay only if someone clicks on their link. This is the equivalent of paying for the delivery of junk mail only to households that read it.

How are companies and the advertising industry responding to these trends in media consumption? Some people do not believe they amount to a sea-change, while others are simply hoping it will not come to pass on their watch, reckons Sir Martin Sorrell, WPP's chief executive.

Nor is it the only significant force he sees at work. New markets, such as China, are becoming increasingly important for advertisers, especially multinationals. But these markets can have very different characteristics. Clients are also more concerned than ever about getting value for money. What will increasingly matter, says Sir Martin, is not what it costs to put an ad in front of 1,000 people (a traditional industry measure), but “how effective is that cost-per-thousand?”

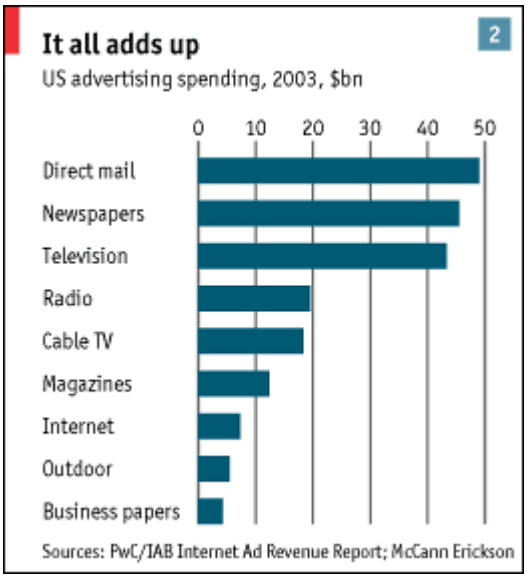
At the same time, negotiating advertising deals is becoming tougher because of consolidation, both among clients and among media owners. This could favour the big, integrated agencies. In May, WPP won a contract to handle all the advertising and marketing for HSBC, after the international banking group decided that parent companies and not their individual agencies should bid for the $600m it spends on such services every year. Samsung, a big South Korean electronics firm, is also expected to appoint a single group.

Nevertheless, the smaller agencies believe they can still compete by being more nimble. “There is definitely a change in the landscape,” says Jane Asscher, chairman of 23red, a London-based agency that describes itself as “media-neutral” in its choice of outlets for campaigns. Ms Asscher believes that consumers are becoming far more sophisticated in their reaction to all forms of advertising and marketing, so smarter ways have to be used to reach them.

During the slump, some companies tried different forms of advertising and liked the response they got. “There's lots of ways to skin a cat today,” says Scott Goodson, founder of StrawberryFrog, an agency based in Amsterdam that specialises in international campaigns. While his firm still uses traditional media, such as TV and print, it is often in conjunction with other techniques, such as “viral” marketing. This means trying to spread the message by word of mouth—still considered the most-powerful form of advertising. Sometimes that involves using the internet for e-mail messages containing jokes, film clips and games, which recipients are encouraged to pass along to friends.

No one knows just how important the internet will eventually be as an advertising medium. Some advertisers think it will be a highly cost-effective way of reaching certain groups of consumers—especially for small companies operating in niche businesses. But not everyone uses the internet, and nor is it seen as particularly good at brand building. Barry Diller, the head of InterActiveCorp, believes network TV is a great place to promote his company's websites, such as Expedia, his online travel agency, and LendingTree, a consumer lender. Unlike bricks-and-mortar businesses, web-based firms do not worry if their ad is being seen by lots of people in towns where they have no shops. They just want people to remember their website address—or at least enough of their name to be Googled.

So far, the internet accounts for only a tiny slice of the overall advertising pie (see chart 2), although it has been growing rapidly. A joint study by the Interactive Advertising Bureau and PricewaterhouseCoopers found that internet advertising revenue in America grew by 39% to $2.3 billion in the first quarter of 2004, compared with the same period a year earlier. Internet ad revenues are now back above what they were at the height of the tech boom.



And Google and Yahoo! have yet to unleash the full potential of their technology. Google, which already places text ads on other people's websites and splits the revenue with them, recently began testing a system to distribute display ads as well, in effect increasing its role as a sort of online ad agency.

Others are honing new techniques. As part of a recent campaign for American Airlines, the online edition of the *Wall Street Journal* used “behavioural targeting” to estimate how likely readers were to be frequent-flyers based on how much interest they paid to travel-related stories and columns. The targeted readers were presented with American Airline ads, and not just when they were reading travel stories. According to Revenue Science, a New York company that developed the targeting system, the results were dramatic: the number of business travellers who saw the ads more than doubled.

The potential for advertising on the internet is tempting more firms to join the fray. For instance, Microsoft is working on a search system with the intention of leapfrogging Google. Microsoft and others see that as more types of media, including music and films, start to be distributed over the internet, there will be more opportunities for online operators to put advertising messages in front of consumers.

Indeed, the makers of personal video recorders (PVRs) recently announced that their new machines will be capable of downloading music and films from the internet, as well as from TV. Many advertisers dread PVRs because they can be used to “time shift” viewing, allowing viewers to record their own schedules with greater ease than existing video recorders. Several studies have shown that users think one of the machine's most-appealing features is the ability to skip past ads. The providers of internet-based content might be able to slip in those ads in other ways than traditional 30-second commercials, perhaps through sponsorship deals or as display ads on the websites which PVR owners will use to select their programming.

Bombarded

People are tiring of ads in all their forms. A recent study by Yankelovich Partners, an American marketing-services consultancy, says that consumer resistance to the growing intrusiveness of marketing and advertising has been pushed to an all-time high. Its study found 65% of people now feel “constantly bombarded” by ad messages and that 59% feel that ads have very little relevance to them. Almost 70% said they would be interested in products or services that would help them avoid marketing pitches.

It has been calculated that the average American is subjected to some 3,000 advertising messages every day. If you add in everything from the badges on cars to slogans on sweatshirts, the ads in newspapers, on taxis, in subways and even playing on TVs in lifts, then some people could be exposed to more than that number just getting to the office. No wonder many consumers seem to be developing the knack of tuning-out adverts.

“Consumers are getting harder to influence as commercial clutter invades their lives,” says a recent report by Deutsche Bank. It examined the effectiveness of TV advertising on 23 new and mature brands of packaged goods and concluded that in some cases it was a waste of time. Although in the short-term TV advertising would lead to an incremental increase in volume sales in almost every case, there was only a positive cash return on that investment in 18% of cases. Over a longer term the picture improved, with 45% of cases showing a return on investment. Not surprisingly, new products did better than older ones. The study concluded that “increased levels of marketing spending were less important than having new items on the shelf and increasing distribution.”

The effectiveness of advertising is a hugely controversial area. Conventional wisdom in the industry is that sales may well increase for a certain period even after the advertising of a product ends. But there comes a point when sales start to decline and it then becomes extremely expensive to rebuild the brand.

This supports the idea of continuous advertising. But some people in the industry believe the conventional wisdom is no longer true. When America's big TV networks reached prime-time audiences of 90% of households, they were a powerful way to build a brand. Now that those audiences might be as low as one-third of households, other ways of promoting a brand have become more competitive. Moreover, many clients never really embraced continuous advertising: when times get tough, just as they did after 2000, one of the first things many companies cut is their ad budget.

Robert Shaw, a visiting professor at the Cranfield School of Management in Britain, runs a forum in which a number of big companies try to monitor the “marketing payback” from advertising. The return from traditional media was, he says, “never terribly good”. Generally under half of ads provide a return on their investment. And there can be various reasons why ads influence sales, other than their direct effect on consumers. For instance, if a producer announces a multi-million dollar ad-campaign, then retailers are often persuaded to increase deliveries. This can result in a “distribution effect” that leads to additional sales.

Some companies have profited from re-allocating their spending across different media, adds Mr Shaw. But it is a tricky business to determine what works best. For many companies, and especially the media-buyers who purchase space and slots for ads, greater media diversity and the arrival of the internet has made a difficult job much tougher.

Soap stars

Some big spenders have already made clear choices. With an annual budget of more than $4 billion, America's Procter & Gamble (P&G) is the biggest advertiser in the world. Ten years ago about 90% of its global ad spend was on TV. Now the figure is much smaller. Last year the company launched a non-prescription version of Prilosec, an anti-heartburn medicine. It was one of the most successful brand launches in the company's history, according to Jim Stengel, P&G's global marketing officer. But only about one-quarter of the marketing spend on Prilosec went to TV. The rest was spent on other forms of marketing, such as in-store promotions.

P&G, which helped to launch TV soap operas as a new way to market goods, is now looking once again for novel ways to reach consumers. Three years ago it set up an operation called Tremor to recruit an army of several hundred thousand American teenagers. It uses them to discuss ideas about new products and to help spread marketing messages. In return, the teenagers get to hear about and use new things before many of their peers.

Getting trendsetters to buy (or be given) new products in order to influence a broader market is hardly a new idea. So-called “early adopters” are a similar group, much sought-after by consumer-electronics companies in order to give their new products a good start. But there is a wider group which marketers sometimes call “prosumers”; short for proactive consumers. Some people in the industry believe this group is the most powerful of all.

Euro RSCG, a big international agency, is completing a nine-country study of prosumers, which it says

can represent 20% or so of any particular group. They can be found everywhere, are at the vanguard of consumerism, and what they say to their friends and colleagues about brands and products tends to become mainstream six to 18 months later. They also vary by category, says Marc Lepere, Euro RSCG's chief marketing officer: a wine prosumer, for instance, will not necessarily be a prosumer of cars.

Such people often reject traditional ads and invariably use the internet to research what they are going to buy and how much they are going to pay for it. Half of prosumers distrust companies and products they cannot find on the internet. If they want to influence prosumers, says Mr Lepere, companies have to be extremely open about providing information.

Despite all of these complications, many in the advertising business remain sanguine. For Rupert Howell, chairman of the London arm of McCann Erickson, which is part of the giant Interpublic group, the industry's latest downturn was the third he has experienced. As it did from the others, he says, the industry is emerging a little wiser. But, he insists, “the underlying principles haven't changed.” Even the arrival of new media, like the internet, does not spell the demise of the old. Indeed, as he points out, TV never killed radio, which in turn never killed newspapers. They did pose huge creative challenges, but that's OK, he maintains: “The advertising industry is relentlessly inventive; that's what we do.”

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About sponsorship

Banking in Iraq

A tricky operation

Jun 24th 2004 | BAGHDAD, LONDON AND WASHINGTON, DC
From The Economist print edition

The slow reconstruction of Iraq's battered banking system

DURING the looting that followed the fall of Baghdad in April last year, the ten-storey headquarters of the Central Bank of Iraq (CBI) was burgled and torched before it collapsed into a pile of soot-stained rubble. Fourteen months later, the charred ruins have been cleared, and the CBI's staff work on American-provided computers in a building nearby.

Rehousing the central bank is one thing. Rebuilding an entire banking system is quite another. Despite the focus on military and political matters, the task has been surprisingly high on the American-led coalition's to-do list: even before George Bush declared that “major combat operations have ended” in May 2003, American advisers were preparing in neighbouring Kuwait. The job is all the more formidable because under Saddam Hussein Iraq had no independent banks to speak of. From the CBI to the lending policies of the six state-owned institutions that controlled most bank assets, the system was under Mr Hussein's thumb. Lending was based on cronyism, not credit quality.

Not surprisingly, inflation and bad loans left the banking system to all intents and purposes insolvent—as far as anyone can tell. Under Mr Hussein, record-keeping was patchy at best. One adviser tells of “madly trying” to reconstruct historical balance sheets at the banks, searching fruitlessly for records of collateral against bad loans, and of the frustrations of wading through opaque financial reports in which accounting “varies from branch to branch and, often, month to month”.

No wonder that most Iraqis chose to stuff their dinars in their pillows rather than in bank accounts—and the habit persisted after the Americans abolished the old currency and printed a new one. With no electronic banking—there are no ATMs or credit cards—most of the Iraqi economy is still based on cash. It works around, not through, the formal banking sector. America's Treasury Department estimates that Iraq's banks' assets amount to just $2 billion, or only 10% of GDP, a “low ratio by any comparison”.

Years of economic isolation, due to sanctions imposed by the United Nations after the first Gulf war in 1991, have also added to the forces keeping banking primitive. Transactions are limited to deposit-taking and infrequent loans—for which banks require collateral worth up to four times the credit. Many bank processes (such as cheque clearing, which can take as little as three days or as long as three weeks) are still done by hand. Electronic links among bank branches, let alone to the outside world, are rare, although this is changing. Until recently, the Coalition Provisional Authority (CPA) paid Iraqi army

pensions by (well-armed) courier.

Despite the unpromising conditions, the CPA, which will be dissolved next week to make way for an interim government run by Iraqis, has made some headway. It has drawn up a framework of laws and rules for the new banking system. A law that came into effect in March established the CBI's independence and laid down its procedures for everything from the management of foreign reserves to bank supervision. A new commercial-bank law governs the functioning of Iraq's 17 private banks, which were legalised by Mr Hussein in the early 1990s in response to a cash crunch following UN sanctions.

A huge training effort has been going on. Advisers from America's Treasury and bank regulators have given classes on subjects ranging from the use of Microsoft Word to the basics of Basel 2, a new treaty on bank supervision. “It is a big challenge, a new way of thinking,” says one American adviser. “Banking based on risk and judgment is radically different from bank decisions based on Saddam's say-so.”

A basic currency reform was also necessary. Under Mr Hussein, there were two lots of dinars: one in the Kurdish north, another elsewhere. Because there were only two or three denominations, worth up to at most $5 or so, even basic purchases required thick wads of notes. So the CPA set to work designing a new, unified currency with several denominations. After frenzied printing in factories from Germany to Kenya, 27 Boeing 747s crammed with bank notes flew to Baghdad. Armed convoys delivered the cash to 240 bank branches across Iraq and officials distributed, in all, two billion pieces of paper. The exchange was completed by January this year with virtually no hitches, a remarkable feat given the insurgency already in progress.

The creation of a single currency has permitted the CBI to carry out a basic monetary policy. The central bank carries out daily currency auctions, receiving about a dozen bids a day according to the CPA. The new dinar has appreciated by 25% or so since its launch, and has traded steadily at around 1,450 to the dollar since January. Inflation has been kept in check, no small thing given that hyperinflation often occurs during and after wars.

Encouraging as all this is, it still amounts to little more than the rudiments of monetary policy and a banking system. Without going much further it is hard to see how the Iraqi economy, which currently depends heavily on American grants and subsidies, can be put on a self-sustaining path.

The six state-owned banks, which comprise most of the banking sector, are still in a sorry state. The four smallest of these, which between them hold 5% of Iraq's bank assets, are “without a doubt insolvent”, according to a CPA official. Four-fifths of their loans are non-performing. The two biggest banks, Rafidain and Rashid, which together account for roughly 85% of the system's assets, may be no better off. They are thought to have lost $100m in the looting. Rafidain was the biggest commercial bank in the Arab world before the first Gulf war, with assets of $47 billion. If its estimated $24 billion of off-balance-sheet borrowing from abroad on behalf of Mr Hussein's regime were factored into its books, it would now be bust.

Exacerbating this is the $120 billion Iraq owes to foreigners (not counting reparations from the first Gulf war). While much of this debt may well be written off, no agreement has yet been reached. Until the extent of Iraq's debt is resolved, the state banks cannot do business abroad. Trade is funnelled through the Trade Bank of Iraq, run by a consortium of 13 international banks, which provides letters of credit for everything from medicine to the services of forensic accountants. It is hoped that Iraqi banks will one day take this over.

Perhaps the best hope lies with the 17 private banks, which are unencumbered by the worst of the old regime's cronyism and unburdened by its debts. But they are tiny, holding just 5% of all bank assets, although their share is growing. None of them has a country-wide presence. Bank of Baghdad, the biggest, has 20 branches; currently, Rafidain and Rashid have almost 300 branches open.

This would seem to be a suitable case for foreign investment to bring in the needed know-how and technology. In January, the CBI granted bank licences to three foreign banks: Britain's HSBC and Standard Chartered, and the National Bank of Kuwait. The new commercial-bank law permits other foreign banks to buy up to 49% of existing Iraqi private banks. At least one-third of the private institutions are already in discussions with other Middle Eastern banks.

All well and good. But so far none of the three licensed foreign banks has entered the Iraqi market. Security is an obvious concern, outweighing, for now, the risk that licences may be revoked if branches are not set up within a year.

And who can be sure that what has already been achieved will not be undone? Some observers worry that once the guiding hands of American advisers have gone, the CBI will become politicised and print money to pay off state debts. It is also possible that the new bank laws will one day be overturned altogether, because of nationalistic bias against foreign ownership or their lack of reference to Islamic teaching. And important as the state of the banking system might be, Iraq's economic health is sure to rest, in the final analysis, on political stability. The future, in other words, is still in the balance.

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Central banking in Zimbabwe

Mugabe's money man

Jun 24th 2004 | HARARE
From The Economist print edition

The world's bravest banker?

LAST year, Zimbabwe became the first country to run out of its own currency. Despite triple-digit inflation, President Robert Mugabe forbade the printing of high-denomination banknotes, as he apparently believed that this would cause inflation. The problem was solved when someone persuaded him that if the central bank issued high-denomination bits of paper called “bearer cheques”, with an expiry date, this was somehow different from printing money. Zimbabweans now buy their groceries with bearer cheques.

A Zimbabwean central banker needs unusual skills. Not only must he steer the monetary ship through perhaps the choppiest economy on earth; he must also cope with a captain whose instinct is to head blithely for the rocks. As it happens, Mr Mugabe has appointed as governor of Zimbabwe's Reserve Bank a man who understands both economics and how to handle an ageing despot.

Since he took over in December, Gideon Gono, a former commercial banker, has brought inflation down from over 600% to a mere 450%. He did this by clamping down on the wholesale looting that emptied the national coffers last year—for example, when politicians took advantage of a loopy official exchange rate to buy hard currency at giveaway prices and spent their windfall profits on mansions in South Africa. A measure of sanity has returned to the forex market, and Zimbabwe now enjoys what passes here for macroeconomic stability.

Buoyed by this success, Mr Gono has accumulated vast powers, including that of determining who gets credit. Ordinary banks have to deposit half their assets with the central bank, at zero interest, as a statutory reserve. However, they can retrieve this cash and lend it to companies the Reserve Bank deems “productive”, at a knock-down 50% interest rate: in other words, super-cheap money for approved borrowers. To say that this system is open to abuse is like saying that recent elections in Zimbabwe could have been a bit fairer.

Of course, the regime's domestic debts remain far more than it can repay. If inflation falls further, the real burden will grow. Mr Mugabe has escaped default before by stealing the accumulated savings of Zimbabweans who work. But those savings are mostly gone, as are the people who earned them.

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Russian banks

Don't run for it

Jun 24th 2004 | MOSCOW
From The Economist print edition

Reasons to be nervous, but not to panic

WHEN a country with a raging separatist war, a shrinking population, collapsing infrastructure and rotting nuclear weapons says that one of its most important jobs is “banking-sector reform”—as Russia's prime minister, Mikhail Fradkov, stated this week—then things in the banking industry must be pretty serious.

Mr Fradkov was trying to reassure a jittery market. Last month, for the first time ever regulators closed a bank on suspicion of money-laundering. In a system where murky ownership ties and shady histories are the norm, the idea that regulators might actually do their job caused pandemonium. CreditTrust, suspected of having the same ultimate owner as the disgraced Sodbiznesbank, suffered a run and went broke. Some 30 first-tier banks briefly cut off lending to second-tier banks. Scared depositors have started “the beginnings of a run” on a couple of other banks too, says Richard Hainsworth of RusRating. This week his agency temporarily withdrew all its 43 bank ratings from public view, so as not to alarm anyone further.

He and other analysts agree with the central bank's assurances that the liquidity squeeze was only temporary. But the flutters showed how the ghost of the 1998 collapse still haunts Russia's banks.

The economy is far more stable than it was then, and the crash cleaned out a lot of the dodgiest banks. Lending has since recovered; between December 2001 and December 2003 it doubled, according to Standard & Poor's. Retail loans have grown even faster. But the country's 1,278 banks still lend too much to a few big borrowers and too little to ordinary people. And people remain suspicious of leaving their money with them: retail deposits are just 12% of GDP, against 55% in the EU.

The central bank has been introducing new rules. These include requiring daily, instead of quarterly, reporting of capital (many banks used to let it drop between reports), imposing tighter rules on the concentration of loans and auditing several hundred banks. The end of this month is the deadline for banks to apply to join a deposit-insurance scheme, which should start working a year from now. In order to join they will need to be more transparent (to regulators, at least) about who owns them and to limit the stakes of offshore shareholders—often the most disreputable—to 10%. Those that will not or cannot join will lose their retail-banking licences.

But will it work? “Russian banks have been very innovative in breaking the spirit of the law while complying with the letter of it,” says Irina Penkina of Standard & Poor's. Russians are masters of the complicated corporate structure and untraceable beneficiary holdings. Most industrial firms have their own banks, which now serve other customers too. Especially in the wake of the government's attack on Yukos, formerly Russia's biggest oil producer, any real or rumoured problems in a company can reverberate on its bank, and the mystery about who really owns what can send ripples all through the system.

In time, the reforms should coax the system towards a healthier shape, in which the myriad tiny private banks consolidate into bigger ones to challenge the state-owned Sberbank, which, with two-thirds of retail deposits and 40% of the total, dwarfs all others. But it will be a couple of shaky years before a regulatory swoop on a hapless bank is seen as reassuring rather than as a reason to panic.

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Mutual funds in America

A rash of rules

Jun 24th 2004
From The Economist print edition

The SEC has handed down its most contentious reform of the troubled mutual-fund business

REFORMING America's scandal-plagued mutual-fund industry is a popular sport in Washington these days. One bill requiring more disclosure of fees and other regulatory changes has been passed by the House of Representatives; two more have been introduced in the Senate. But the Securities and Exchange Commission (SEC) has beaten Congress to it. At a testy meeting on June 23rd, the commissioners voted 3-2, in a rare split decision, to approve the most contested of its several proposed reforms.

From the end of next year, three-quarters of a mutual fund's directors will have to be independent of the company that manages the money, up from half hitherto. The chairman must be independent too. The idea is that on matters such as the fees paid by investors to management, the board will now be on the investors' side.

Much upheaval is in store: only one-fifth of the fund boards currently have independent chairmen, according to the Investment Company Institute, an industry association. But if mutual-fund managers are unhappy, they have only themselves to blame. They proclaimed their virtue during the Enron era, only to find themselves pursued last autumn by Eliot Spitzer, New York state's attorney-general. All sorts of fiddles came to light.

Some fund managers, such as Janus and Strong Capital Management, allowed favoured clients to make rapid, undisclosed trades in fund shares. This practice, dubbed “market timing”, imposes trading costs on all investors in the fund, but allows a privileged few to skim off a quick profit. Other managers allowed “late trading”—in essence, clients placing orders after 4pm, the end of the trading day, when funds' prices are set. Regulators also peered into managers' murky fee structures and their often cosy dealings with brokers who peddle their funds.

In essence, mutual-fund managers were guilty of putting the tending of money already in their care (now totalling $7.4 trillion) second to the seeking of new business and thus more money for themselves. The 16 reforms the SEC is considering this year are supposed to change that.

Already the commissioners have imposed a code of ethics and have ordered firms to disclose their policies on market timing. This week they also approved, unanimously, a rule designed to encourage fund boards to consider their contracts with investment advisers more carefully. And they will soon vote on whether to impose a 2% levy on fund shares sold within five days of buying them, in an effort to discourage market timing. Other proposals focus mainly on disclosure—of brokers' possible conflict of interest, of the fees funds pay to brokers and of information about portfolio managers. The SEC is also considering whether to bar all processing of orders after 4pm.

Some fund managers are already reforming themselves as they try to woo back investors, many of whom have decamped to firms that have remained unscathed, such as Fidelity or Capital Research (see article). One reformer, Massachusetts Financial Services (MFS), has been especially energetic, having settled charges of market timing and of failure to disclose that it used brokerage commissions to pay for marketing. MFS named independent co-chairmen for its funds, and is about to start providing its investors with itemised estimates of fund managers' fees.

Such changes have not been cheap. Cutting out “soft dollars”—payments for services such as research that are hidden from view because they are bundled into brokerage commissions—is costing MFS more than $20m a year, according to Robert Pozen, the new corporate chairman of MFS and a stickler for rules. In recent testimony to Congress he gave a strong lead to the rest of the industry.

But will the reforms work? Most managers are adamant that the requirement for an independent fund chairman will create only hassle. Fidelity argued in a letter to the SEC that there was no evidence that such a rule would do anything either to limit fees or improve investment performance. Indeed, some companies, such as Putnam, fell prey to market timing despite having independent fund chairmen. There is also a question about how many independents can even be found: being on a board these days means hard work and the risk of being sued.

Other proposed reforms are also touching nerves. The mooted 2% levy on shares redeemed within five days could hurt, say, today's buyer who unexpectedly finds himself strapped for cash tomorrow. The proposed ban on trading after 4pm will inconvenience pension funds, which tend to collect orders until 4pm and then submit them for processing later—a different matter from the late placing of orders, which the SEC is trying to root out. West-coast funds, which are three hours behind New York, especially need this extra time. Tony Evangelista of PricewaterhouseCoopers says that new technologies, such as sequential time-stamping of orders, could render this reform unnecessary by making it impossible to pretend that late orders were in fact placed before the close of the trading day.

Indeed, plenty in the industry are muttering about over-regulation. Mr Pozen predicts that the new rules will make it harder to persuade fund investors to accept increased fees, thus driving margins down and harming managers of small funds especially. He also notes that mutual funds will now be far more heavily regulated than rival financial instruments, such as hedge funds or even common trust funds and insurers. “We have a very elaborate code of ethics. Do insurance companies?” he asks.

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September 11th compensation

Calculating tragedy

Jun 24th 2004 | NEW YORK
From The Economist print edition

A hard task is over: hard questions remain

AP

The fateful day

IT TOOK almost a year to clear the rubble from the World Trade Centre site. On June 15th another enormous, but less visible mess was finally sorted out, with the announcement that the fund created to compensate victims of the attacks on America on September 11th 2001 had determined the value of its last claim. The final cheque will arrive by the third anniversary of that dreadful day.

The fund was created by Congress both to provide money for the bereaved and injured without having to spend years in court and to spare airlines crippling litigation. Its operation has exceeded all expectations. There were no complaints about bureaucracy and only two claims deemed worthy of prosecution for fraud. Yet there is still no consensus about whether the fund should have been set up at all.

In total, the fund will have paid $7 billion to settle 4,400 claims for personal injury and 2,900 for death. Payments average $2m. For injuries, they range from $500 for a broken finger to $8.6m for extensive burns. The highest death benefit is $7.1m, said to have been paid to the family of an executive at Cantor Fitzgerald, a broking firm, after a deduction of more than $1m in life insurance. A minimum of $250,000 was set for each death, plus $100,000 to each surviving family member.

Most important, the fund was broadly accepted by victims of the attacks, even though many of them were critical at first. Few opted out. About 30 did nothing, possibly because they were too depressed to fill out a form. Another 90 chose to sue the airlines, airports and security companies. “These are people for whom accountability and the litigation process are more important then the certainty of a compensation-fund award,” says Marc Moller of Kreindler & Kreindler, the lead plaintiff attorney. A trial date is likely to be set this autumn. Testimony is expected to begin in the spring. A conclusion could take years.

After finishing the last claim, Kenneth Feinberg, the special master appointed by John Ashcroft, the attorney-general, to run the fund, took a five-day, transcontinental rail trip, his first break since the fund began. A pioneer in mass tort settlements and a former employee of Senator Edward Kennedy, he agreed to work without pay. He personally heard petitions from 800 claimants and believes that, individually or in group meetings, he met every eligible person, using interpreters to communicate in half a dozen languages.

As important as empathy, however, was the shaping of the fund. Congress had left room for interpretation: Mr Feinberg filled in the gaps. A key decision was how he treated his obligation to

consider economic losses. This should in theory have produced enormous sums for the rich and much less for the poor. Mr Feinberg went beyond the strict wording of the statute and consciously “narrowed the gap”. He held back on potentially huge settlements—which may explain why some claimants decided to opt out and sue—and bolstered small ones. He reasoned that Congress did not want most of the money to go to the rich, but had intended the fund to be a safety net.

Originally, family members of those who died were to be granted $50,000 in non-economic compensation to cover pain and suffering. The amount was then doubled—not because of any theory or precedent, but because people complained. As required by Congress, life insurance was deducted from awards, on the theory that the settlement should reflect all compensation due as a result of the attack. This principle was not consistently applied. Payments by charities were not deducted, because the charities said they would withhold their contributions if they were, at a cost to victims of $2 billion.

For its principles, the fund drew on tort law, private and government insurance, and welfare, says George Priest, a professor at Yale Law School, but with no consistency and no cap on the amount paid other than Mr Feinberg's sense that Congress did not want a runaway programme. Under tort law, for example, people are to be “made whole” for damages; there is no deduction for life insurance. As a deterrent, those who cause harm pay for the settlement. In this case, payment came from taxpayers. Welfare schemes give most to those who have least. Yet here the government is paying most money to those who had most. Is that the best use of taxes? It seems inevitable that as details emerge about why people in superficially similar situations got different settlements, questions of fairness will increase.

Mr Feinberg's own role has been controversial. He wrote the rules, adjudicated the validity of claims and approved all financial payments: he was judge, jury and exchequer. Notwithstanding broad praise for his performance, could that possibly be a good precedent? If there were another such tragedy, Mr Feinberg allows, it might be better not to appoint someone to fill the exact role he had this time. Instead, each victim could be paid an identical amount, or several broad tiers for compensation set up. But if that were done, should victims then be denied the right to sue? There is no easy answer.

And this skirts the most awkward question: should the victims of September 11th have been given anything at all from the state? Mr Feinberg says he has received letters from victims of the Oklahoma City bombing and the World Trade Centre bomb attack in 1993, asking why the government did not make similar arrangements for them. “You can't look at a program like this from the perspective of the victim,” he says. “There is no convincing explanation.” It was, he concludes, “a unique response by a nation to a unique attack.” One hopes so.

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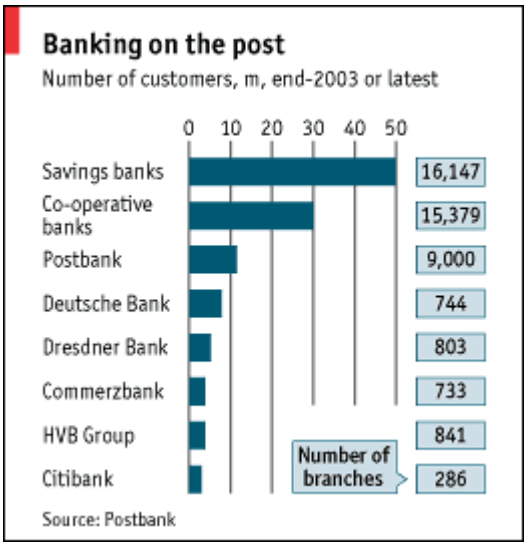
German capital markets

Acrimony all around

Jun 24th 2004 | FRANKFURT
From The Economist print edition

Troubles on the way to Postbank's share issue have not been the only problem bedevilling Germany's financial markets



THE flotation of almost 50% of Postbank, arguably Germany's most successful retail bank, ought to have been easy. But if things can go wrong in the country's capital markets, they usually do. Last month a leaked memorandum from Deutsche Bank, one of the issue's lead managers, suggested that the shares could be worth one-tenth less than the minimum asking price. That caused bad blood between the bank and Deutsche Post, Postbank's state-controlled parent. A last-minute effort by politicians to have Postbank merge with Deutsche Bank instead of floating only added to the confusion.

The over-priced deal was rescued only when Klaus Zumwinkel, boss of Deutsche Post, yielded to “the market”, as he put it, on June 20th. The asking price was lowered, the listing was postponed for two days, and one-third of the planned issue was bundled into a convertible bond. Postbank's shares began trading on June 23rd and remained buoyant just above the launch price of €28.50 (around $34.50).

The Postbank saga has scarcely shown German capital markets in a good light. Nor has it been the only problem. For a year, politicians and financial institutions have been engaged in a new initiative to make the country a more attractive financial centre. Bitching between the various banking associations has threatened to ruin the initiative altogether. Dietrich Hoppenstedt, head of the public-sector savings banks' association, the DSGV, recently called the association of private-sector banks “ideologues” bent on confrontation. He was incensed by a report by the private side which blamed the public-sector banks for distorting the market and blocking consolidation and change.

Underlying this row is the refusal by regional lawmakers to allow savings banks, which are owned by local communities, to be sold to private-sector buyers. Until that happens, argues Manfred Weber, chief executive of the private banks' association, cross-border consolidation of banking in Europe can hardly include Germany. He has a point: the German banking sector is fragmented, with around 500 savings banks (as well as 1,400 co-operatives). Mr Hoppenstedt wants to steer discussions away from questions of structure. He insisted at a bankers' meeting last week that attacks on the savings banks' founding principles should be left out of the debate.

But the savings banks and the wholesale Landesbanks, which they partly own, are under the spotlight whether Mr Hoppenstedt likes it or not. By July next year any new money they raise will not carry a state guarantee. The Landesbanks are in intensive discussions with rating agencies and the financial regulator, BaFin, about their future credit standing. Standard & Poor's is due to publish prospective ratings for them next month.

Reputational issues in Frankfurt have unsettled the atmosphere too, and not only because of the way Deutsche Bank handled the Postbank listing. The once-mighty Bundesbank is under fire for poor governance, having allowed its recently replaced head, Ernst Welteke, to accept paid-for publicity jaunts, and having built luxury villas to house its senior executives.

Optimists argue that these problems are correcting themselves. Certainly, in the Postbank offering

market forces eventually prevailed: institutional investors called the shots on pricing. However, had the issue been better handled it might have been big enough to send Postbank into the DAX index of 30 blue-chip stocks. Moreover, reforms to remove structural inefficiencies from financial markets are proceeding too slowly. For instance, although a law allowing hedge funds to set up in Germany came into effect on January 1st, no fund based on the standard hedge-fund practice of pledging collateral to a prime broker in order to make leveraged bets has yet won regulatory approval. Or take the securitisation of bank loans: a “true sales” initiative announced in April 2003 to allow an actual, rather than a synthetic, transfer of risks is still not up and running.

There has been little recently to whet the appetites of investors, many of whom were traumatised by the decline and eventual collapse, two years ago, of the Neuer Markt, the Frankfurt stock exchange's new-economy segment. There were two small share issues last month, but three others were withdrawn. The Postbank fiasco also makes the job of Hans Eichel, the finance minister, more difficult. He wants to raise around €5 billion next year from sales of state assets. On his books there are still stakes in Deutsche Telekom and Deutsche Post worth around €20 billion at today's market prices. Mr Eichel is lucky in that he has a fall-back—he can “sell” assets to the Kreditanstalt für Wiederaufbau, a state-owned development bank. But that would hardly help to develop Germany's struggling capital markets.

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Economics focus

Grey hair, red ink, but blue skies?

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A new study says that worries about Japan's public-sector debt are vastly overblown

Get article background

WHEN an economy is as troubled as Japan's, gloom can be hard to shake off. Even if its latest recovery proves lasting, pessimists warn, the past 14 years of economic torpor have rendered Japan helpless in the face of an inevitable demographic crunch. Nothing captures this belief better than chronic worries about Japan's public debt. Only this week analysts at Moody's gave warning that the debt was unsustainable: if debt keeps rising faster than GDP, the eventual result must be default.

Japan's gross debt is now half as big again as its GDP. With deficits adding 8% of GDP to the pile each year, and growing ranks of senior citizens pushing spending up further, it seems only a matter of time before Japan collapses under the weight. Indeed, a recent sharp rise in long-term government bond yields has called fresh attention to Japan's fiscal problems. Even if growth does continue for a while, many argue, the bond markets will ruin the party by reminding everyone of impending doom.

Amidst these dire warnings, it takes courage to lift one's head up for a long, hard look over the horizon. It helps greatly, however, if those doing the looking can steady themselves by leaning on first principles. That is what Christian Broda, of the Federal Reserve Bank of New York, and David Weinstein, of Columbia University, have done. In a paper* they presented this week in Tokyo, they offered a far more hopeful analysis than most of Japan's long-term public finances.

They conclude not only that Japan's debt levels are sustainable, but also that Japanese voters will have plenty of room to decide how comfortable or how spartan they want their welfare state to be. The public sector's gross liabilities in March 2003 stood at 161% of GDP, but this figure is misleading in several ways. For one, it includes debts that different parts of the government owe to each other. Bonds held by the central bank and other government entities are assets on their balance sheets, so the net debt associated with those liabilities is zero.

After cancelling out these intra-governmental claims, the debts that Japan's government actually owes to other parties are much less intimidating: only 46% of GDP. Adjusting for questionable loans that the government has made to the private sector, the authors reckon that Japan's public sector owes net consolidated debts of 62% of GDP. That is higher than America, but lower than the OECD average.

The authors also dispute the idea that public spending is out of control. Although often accused of priming the pump, the government has barely touched the handle over the past eight years. Government outlays have risen as a share of GDP, but this is entirely accounted for by the growing number of Japanese aged 65 or over, who receive transfer payments from everyone else. Public-works spending may be excessive, and certainly supports obstructive elements of the ruling party, but it is no higher now, relative to GDP, than it was in the 1980s. Indeed, the only real stimulus the government has imparted since 1996 has been through lower average taxes. This leaves Japan, which has the second-lowest average tax rate in the OECD, next to South Korea, plenty of scope to shore up its finances.

Nor are Messrs Broda and Weinstein worried about an ageing and declining population. Japan is certainly greying, and its fertility rates are indeed low. But the authors point out that if Japan's fertility rate were to remain at its current low level, and the average woman were therefore to bear 1.3 children, the population would die out in around 800 years. They argue that this extrapolation, which is used in many long-run economic forecasts, is stupid, because it ignores the likelihood that at some point the fertility rate will rebound a bit. Rising incomes, for example, are likely to lead Japanese women to have slightly

more children than they do now, eventually stabilising the population. “Once one rejects the idea that the Japanese will cease to exist,” they say, tongue in cheek, “policy options abound.”

Painful, but manageable

Since its population will no doubt stabilise at some point, rather than dwindling to nothing, Japan will have many years over which to spread the welfare costs of its temporary surge in elderly citizens. Messrs Broda and Weinstein make several estimates of how far taxes will have to rise to stabilise Japan's finances, based on different assumptions about economic growth, interest rates and the evolution of Japan's welfare state. Even in the worst scenarios, which seem unrealistic, Japan's tax rates would have to rise to the level of a typical European Union country in order for its debt to be sustainable. That might be uncomfortable for taxpayers, but not catastrophic.

However, Japan ought to be able to get by with much lower average tax rates. Just as more old people means more spending on benefits for the elderly, fewer young people should mean less spending on benefits for children and people of working age, such as schools and unemployment benefits. If Japan chooses to rein in spending, its average tax rates should be comparable to those in America. If it chooses to be more generous, taxes will have to rise by more. In effect, it is a political choice.

A shift of three to nine percentage points in tax rates, as the authors' range of reasonable forecasts implies Japan must one day do, will be painful. But it is manageable. The authors also calculate that today's deficits can continue for a while with little or no effect on the sustainability of the country's debts. So are the pessimists completely wrong? Not completely, because at some point Japan's voters and politicians will have to face awkward choices. But fiscal implosion seems unlikely.

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* “Happy news from the dismal science: reassessing Japanese fiscal policy and sustainability”. The paper will be available soon on Mr Broda's website: http://nyfedeconomists.org/broda/pub.html

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Manned spaceflight

The Starship Free Enterprise

Jun 24th 2004 | MOJAVE
From The Economist print edition

AP Scaled Composites

A milestone in the birth of a new kind of space age

Get article background

IT IS early in the morning in Mojave, and a pink blush has appeared on the horizon. One by one the stars are fading, and to the south of the airport a line of car headlights snakes into the distance. There is, however, no chance of hearing birdsong during what would otherwise be a serene desert dawn, for rock music is pumping out of huge speakers along the runway. Welcome to the age of commercial spaceflight. Prepare your chequebook for take-off.

On June 21st, Mike Melvill fired his rockets, hit three times the speed of sound, and took *SpaceShipOne* to an altitude of 100,124 metres (about 62 miles) before coming back down to Earth. It was the first privately built craft to fly a human into space, and later that day Mr Melvill became the first private pilot to be awarded astronaut's “wings” by the Federal Aviation Administration (FAA).

In awarding those wings, Patti Grace Smith, the associate administrator for commercial space transportation at the FAA, said the flight opened a new chapter in history, bringing access to space within the reach of ordinary people. Sure enough, tens of thousands of such people seemed to feel the same. They chose to make the pilgrimage to watch *SpaceShipOne* enter the history books because they were inspired by a sense of occasion, and the hope that this would expedite the development of space travel.

They are probably right to be excited. Ms Smith's definition of “ordinary people” may not match that of most of her fellow Americans (current estimates are that a flight into space will set you back $30,000-100,000), but something new and interesting is definitely happening. For *SpaceShipOne* cost a mere $20m.

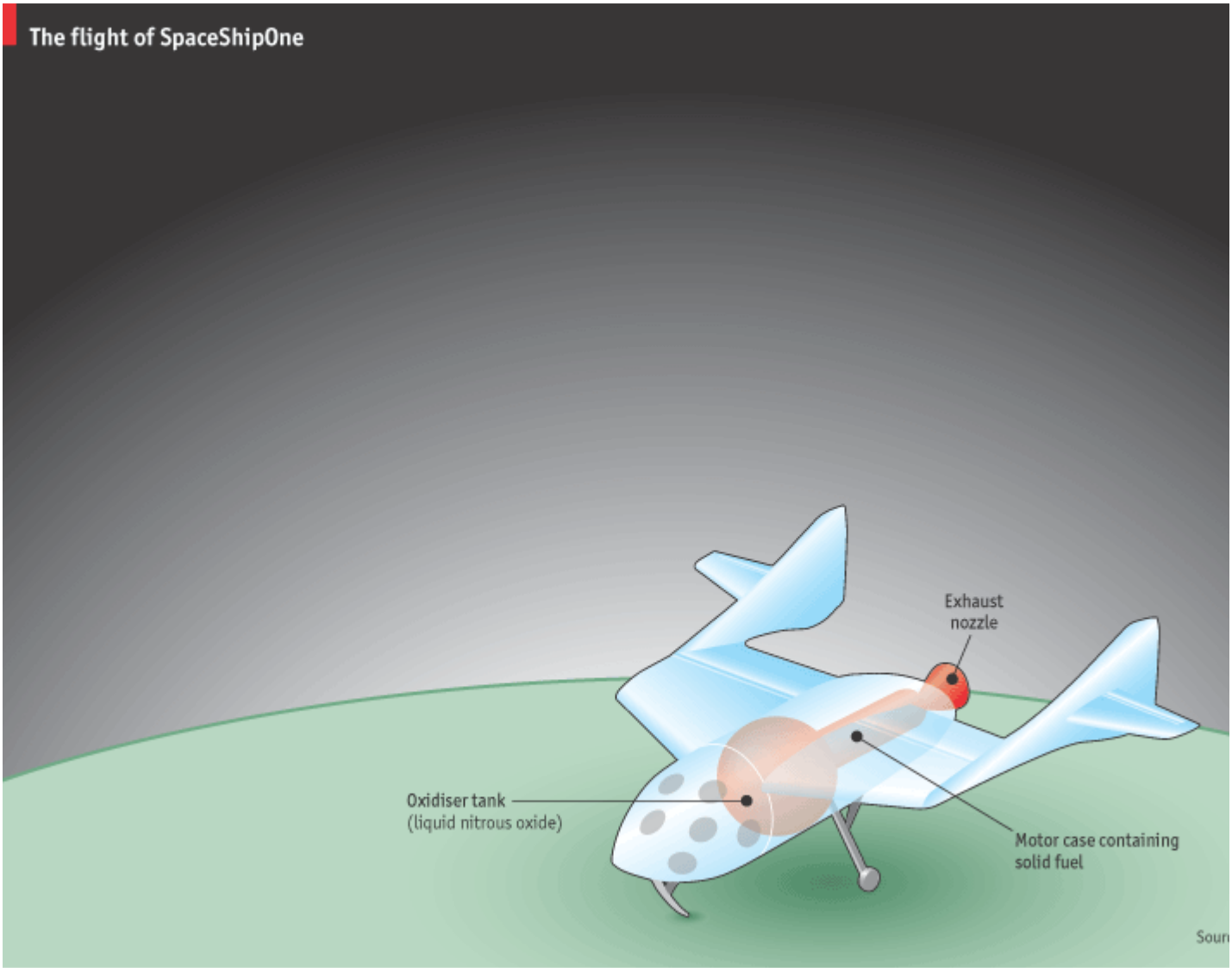
This is a surprisingly reasonable price. The craft's sponsor, Paul Allen (who co-founded Microsoft), could have spent as much, or more, on a luxury yacht. Furthermore, there is cause for modest optimism about the changes that the flight of *SpaceShipOne* signals in the broader space business, as a new breed of entrepreneur creates a thoroughly modern industry.

In the short term, the next step for *SpaceShipOne* is to prepare for two further flights that could win it a $10m prize. The Ansari X Prize is an award for the first privately financed team to build and launch a vehicle capable of taking a pilot and two tourists into space twice within two weeks. But although *SpaceShipOne* landed flawlessly, the flight was not perfect. If the problems cannot be fixed quickly, they

will delay Scaled Composites, the local firm that built *SpaceShipOne*, in its attempt to win the prize.

SpaceShipOne suffered two malfunctions, one of which Burt Rutan, the craft's designer and the founder of Scaled Composites, described as the most serious safety problem he has encountered so far. This was that when Mr Melvill fired his rockets, the craft suddenly rolled 90° to port. Although he was able to correct this, the system that runs the aerodynamic control surfaces of the craft subsequently malfunctioned. As good luck—or rather good design—would have it, there was a back-up. But he also had a scare when, during the ascent, he heard a loud bang. This is believed to have been caused by the buckling of a piece of fairing—a lightweight covering that slightly reduces drag. These problems meant that the craft only just managed to exceed its target altitude of 100km.

To infinity and beyond



The aim of the X Prize Foundation is to jump-start the space-tourism industry. Mr Rutan and Mr Allen, too, have such a dream, and have been working at it since 2001. They want to show that space can be reached much more cheaply and reliably than at present. Most space entrepreneurs are driven by a belief that America's space agency, NASA, has failed in its responsibilities in this area. Only Mr Rutan, though, will say such a thing openly. He has won many fans. After the flight, he proudly waved a sign he had been given by a member of the public. It read, “Space Ship One. Government Zero”.

Despite much excitement over the X prize, though, only a few of the more than 20 groups that have registered their wildly differing ideas with the prize foundation have any realistic chance of winning. Furthermore, of those few, it is unclear whether any have designs that will suit commercial operation. Jeff Greason is the CEO of XCOR Aerospace, another small firm based in Mojave, which designs, tests and builds flight hardware. He worries that the prize, with its attached conditions, may not lead to the right sort of craft being built. Prize entrants simply need two flights in close succession, and are not necessarily motivated to develop a vehicle with low operating costs.

Mr Greason's company has a prospective design for a suborbital vehicle, *Xerus*, that could fly a single tourist into space. That automatically disqualifies it from winning the X prize. But *Xerus* is designed to make money. As Dan DeLong, the firm's chief engineer, points out, it is necessary to take more than one passenger only if the cost per launch is high.

Mr Rutan, naturally, has his own ideas about what a truly commercial vehicle would look like. He seems to favour craft that would carry more people—perhaps between six and nine. He estimates that the first tickets would cost between $30,000 and $50,000. A second-generation vehicle, he speculates, might bring the cost down to between $7,000 and $12,000. That is about the price of a luxury cruise. But he has not published the costs of operating *SpaceShipOne* and its carrier jet aircraft *White Knight*, so it is difficult for his competitors (as well as everybody else) to work out what a ticket might actually cost.

A back-of-the-envelope calculation gives some idea. Mr Rutan says his highest costs are staff for the pre- and post-flight check-ups. He has a few dozen staff and, at one point, had a plan to run *SpaceShipOne* once a week for five months. Assuming each of his staff cost $120 an hour to employ, it would cost a minimum of $60,000 per tourist for staff alone. On top of that come the costs of fuel, compliance with regulations, depreciation and, naturally, profit. That bumps the figure up to something nearer $100,000. Fortunately, studies have shown there would be a market for flights into space even at this price. In this context it may be no coincidence that Mr Melvill, though a fit and experienced test pilot, is 63. For a certain sort of retiree, a trip into space would be a desirable alternative to a cruise round the world. By picking Mr Melvill to fly *SpaceShipOne*, Mr Rutan has given America's elderly rich a subtle reminder that space could be for them, too.

Indeed, Space Adventures, a firm based in Arlington, Virginia, which has already brokered three tourist trips on Russian rockets to the International Space Station, is promising customers a trip on the first vehicle that goes into commercial operation. It has set a ticket price of $100,000, and has sizeable deposits for 100 trips. XCOR certainly believes *Xerus* could operate commercially at this price.

AP Scaled Composites

The big unknown (and one that is bothering potential investors) is the cost of compliance with government regulations. If a spacecraft cost the same as an aircraft to certify (several hundred million dollars), the industry would not get off the ground. Aircraft companies can spread the cost of certification over many units. That would not be true (at least at the beginning) for spacecraft manufacturers. Government inspection has already, according to XCOR, added three years to the *Xerus* project.

Mr Rutan will not say whether he is going to try to build a craft that will take paying customers, though several reports have suggested he is putting together a business plan to do this. Mr Allen confirms that he is interested in investing in commercial operations, but says he has not reached a decision. Other wealthy entrepreneurs, such as Dennis Tito (the first of the tourists taken up by the Russians) and Sir Richard Branson (proprietor of the Virgin Group), who have expressed an interest in commercial space ventures, turned up to the launch of *SpaceShipOne*. Mr Tito appears ready to make an investment in the space-tourism market as soon as the legislation under which it will be regulated is finalised. Unfortunately, a bill that would do this is currently stuck in the American Senate and may run out of time this year.

Better by design

SpaceShipOne is, according to Mr Rutan—an experienced aeronautical engineer who designed the first aircraft to fly around the world without refuelling—the hardest thing he has ever built. Success came from using cheap, off-the-shelf technology where possible, and innovative design elsewhere. There was also a certain degree of pragmatism. Mr Rutan chose to work with composites, not because they were optimal but because he had decades of experience building aircraft with them.

One novel aspect of his design was the “feathered” re-entry. Re-entering the atmosphere is the most dangerous part of a mission. Three of the four fatal accidents on manned missions have happened then. In a feathered re-entry, the wings are folded to provide a “shuttlecock” effect that gives the ship high drag. Deceleration occurs at a higher altitude which, because the atmosphere is thinner there, reduces

the forces involved and the amount that the structure heats up. The feathered configuration also aligns the ship so that the pilot can control the flight more easily.

Despite the brouhaha, though, *SpaceShipOne* has only dipped its toe into outer space. Its flight was merely suborbital. Getting into orbit is a trickier game to play. Although nobody at Scaled Composites has said anything formal about orbital flight, the company is interested. “We do not plan to stay in low Earth orbit for decades,” said Mr Rutan. “Hold on, the next 25 years will be a wild ride.”

In any case, Mr Rutan has already thought about how suborbital tourist craft need to differ from orbital craft. To yield the full “being in space” experience, a suborbital craft would have to be large enough to allow passengers to bounce around and enjoy weightlessness—and the flight would have to last long enough for a satisfactory amount of bouncing to occur and for there to be time to look out of the window and take pictures. For this, he says, a vehicle would need to be bigger than *SpaceShipOne*, and would have to go significantly higher. Orbital craft, though, could be quite different. They could be cramped and windowless as long as the intention was to deliver the passengers to a structure such as a space hotel.

AP

Who are you calling an old fogey?

Although such a hotel sounds futuristic, it is not an impossible idea. Bigelow Aerospace, of North Las Vegas, Nevada, for example, wants to build one using inflatable components. These would be light, and therefore cheap to launch into orbit. Robert Bigelow, the firm's founder (and also the owner of the Las Vegas-based Budget Suites of America hotel chain) thinks there is a viable business here. If all goes to plan (and things rarely do in the space business) Bigelow will eventually launch a test structure on the Falcon V booster that is currently being developed by another new company, Space Exploration Technologies Corporation (SpaceX), of El Segundo, California.

Nevertheless, it is a huge leap in cost and technology to get into orbit, warns Elon Musk, the founder of SpaceX and a co-founder of PayPal, an online-payments firm. So SpaceX is first developing a “lite” version of Falcon V, a low-cost, partly reusable satellite launcher called Falcon I. The firm is well on the way to flying this at a price that will undercut its established competitors by more than 70%. SpaceX has three launch contracts so far. The first (a satellite for the Defence Department) should come to fruition quite soon. There is strong military interest in small, cheap launchers that can be ready in weeks rather than months. These would enable America's forces to put tactical satellites up on demand during a conflict.

Another company that would like to get into the satellite-launching business is SpaceDev, of Poway, California. This is the firm that built the “hybrid” liquid/solid-fuelled rocket motors which power *SpaceShipOne*. It proposes to use similar motors (which burn a solid rubber fuel in liquid nitrous oxide) for satellite launches, rather than employing the purely liquid-fuelled rockets used by Mr Musk's outfit. But, it says, it will take at least three years to develop the technology. The advantage that hybrids have over liquid-fuelled rockets is that they are cheap to develop and generally safer to store and operate, though some people question whether they will ever be powerful enough to launch things into orbit.

Whether this new breed of entrepreneurs succeeds in bringing down the cost of access to space for both people and cargo remains to be seen. Costs have remained static, at $20,000 per kilo put into orbit, for decades. By contrast, Mr Musk highlights the huge improvements in cost and performance during the history of information technology. With IT entrepreneurs such as Mr Allen, Mr Musk and also Jeff Bezos, the founder and chief executive of Amazon.com, getting into the space business, it seems that winds of change are blowing through the industry.

SpaceX, though, is restricting itself to non-living cargoes at first. As for getting people into orbit cheaply, this is much further off. To reach orbit it is necessary to travel at 25 times the speed of sound. There is a huge gulf between this and the speed needed for a suborbital flight. Moreover, bridging the gap is not merely a matter of more oomph in the engines. The more power you need, the more fuel you have to carry. And that fuel itself needs fuel to lift it. The result is that more than 90% of the launch weight of a craft destined for orbit is fuel. Building a lightweight container for that fuel is no easy task.

On top of this, the energy used to get into orbit has to be dissipated during re-entry, so better heat shielding is needed than for a suborbital flight. Thirdly, the speed of orbit leaves little room for

manoeuvre, so it would be necessary to develop a precise guidance system for the craft.

None of which is to detract from the achievement that Mr Rutan's skill, Mr Allen's money and Mr Melvill's daring have pulled off. They, and those like them, understand that in this area, as in so many others, real progress will happen only when small, innovative firms are allowed to flourish.

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About sponsorship

The autobiography of a president

Good ingredients, badly cooked

Jun 24th 2004 | WASHINGTON, DC
From The Economist print edition

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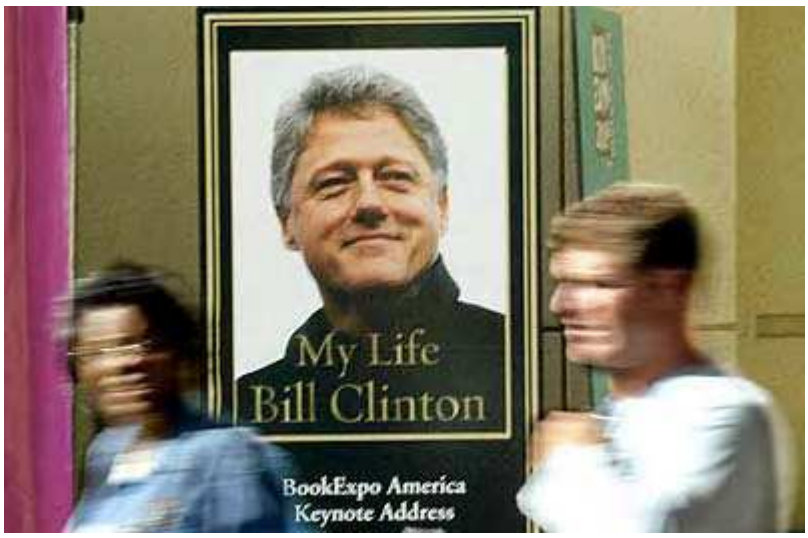
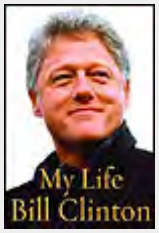


A long-winded ramble by America's last Democratic leader

IN HIS admirably brief prologue, Bill Clinton confesses that when he was a young man just out of law school he bought a book called “How to Get Control of Your Time and Your Life”. It recommended that readers make a list of their goals and then categorise them in order of importance. On his list young Bill included: be a good man, have a good marriage and children, have good friends, make a successful political life, and write a great book.

Who can doubt that Bill Clinton has everything it takes to write a great book? He has an extraordinary story to tell—or rather an extraordinary series of stories. How did a poor boy from nowhere make it to the top of the plutocratic world of American politics? How did a man from a two-bit southern state manage to drag the Democratic Party back to the centre? And why did a man of such prodigious talents repeatedly risk his career for a bit of illicit pleasure?

My Life
By Bill Clinton



Knopf; 957 pages; $35.
Hutchinson; £25

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Amazon.com
Amazon.co.uk

He also clearly has the talent necessary to do the telling. Mr Clinton is capable of extraordinary eloquence: witness his riveting speech in 1993 to the Church of God in Christ in Memphis. And he has an admirably well-stocked mind: this book is full of details about books read and places visited. Add to this his legendary ability to connect with ordinary people and you have all the ingredients of a great political autobiography.

Alas, “My Life” is very far from being great, or even particularly good. The book is so long-winded and ill-disciplined that the genuinely good bits get lost in the verbiage. Mr Clinton regales us with tedious lists of conferences, meetings and campaign stops. The editors should be hauled over hot coals for failing to hold their celebrity author to higher standards. If they had devoted a fraction of the energy to editing this text that they did to marketing it, then the turkey might have had a chance to fly; as it is, it is destined to sit on the coffee tables of liberal America, lightly thumbed and quickly discarded.

The best part of the book deals with his early life. Mr Clinton comes from the sort of world that John Kerry has only witnessed in films: a world of casual violence, unstable relationships and shady

characters. His father died in a car crash before he was born. His stepfather was an abusive alcoholic who once shot a gun in the general direction of his wife and stepson.

How did he manage to climb out of such a chaotic background? Partly because he had a precocious interest in a profession that has traditionally provided a means of upward mobility in the South—politics. And partly because the mechanisms of upward mobility were in pretty good shape in the 1950s and 1960s. His high school offered four years of Latin as well as plenty of maths. A group called Boys Nation identified him as a budding leader—and took him to the White House to meet JFK. He won admission to Georgetown University (where he supplemented his income and sharpened his knowledge of politics by working for Senator William Fulbright). From there he won a Rhodes scholarship to Oxford (where he spent two years and met several people who later worked in his administration).

Mr Clinton also offers some interesting clues as to why he was so keen on dragging his party back to the centre. He spent his early life among the sort of people whom the Democratic elites regarded as little more than yahoos, and he realised early on that it had to reconnect with these people if it was to survive. The best character sketches in the book are not of whizz-kids but of Arkansas reactionaries such as Arlo Tyer who wanted to impose a tax on couples who lived together out of wedlock.

But no sooner does Mr Clinton emerge on the national stage than his narrative degenerates into a blur. He provides nothing more than a bland summary of the policies that revivified his dying party. And he resorts to ever more boring accounts of political events and legislative achievements. This has the merit of demonstrating just how many decisions an American president faces in the average day. But it also robs the reader of any sense of what those decisions actually mean.

That woman

“My Life” perks up a bit with the arrival of Monica Lewinsky. Mr Clinton tells us that Hillary looked as if she had been hit in the gut when he confessed to her, and that he had to spend several months sleeping on the couch. He explains his behaviour in terms of a disturbed childhood that taught him to keep his private life walled off from public view.

Yet Mr Clinton's refusal to admit that his behaviour with Ms Lewinsky was part of a wider pattern of infidelity turns what ought to be an act of self-revelation into a self-serving excuse for his wrongdoing. (The other women in his life, such as Gennifer Flowers, are treated merely as political problems to be managed.) He then deftly shifts the argument away from his own misdemeanours to the evils of the right-wingers who made it their mission in life to destroy him.

Mr Clinton promises to spend the next few months selling his book, particularly focusing on swing states where his electric presence may shift a few votes. If this had been a better book, he might have been more of an asset to the Kerry campaign. As it is, liberals will be bored by the endless list of achievements, and conservatives will be reconfirmed in their belief that the 42nd president is an ill-disciplined braggart with a slippery way with the truth.

My Life.
By Bill Clinton.
Knopf; 957 pages; $35.
Hutchinson; £25

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Politics in China

Suffrage on sufferance?

Jun 24th 2004
From The Economist print edition

TO MANY, the title of this book will seem like an oxymoron. China's future may be prosperous and powerful, or precarious and chaotic—but surely not democratic? The Chinese Communist Party seems as secure as it has been at any time in its 55 years in power, delivering a combination of high levels of economic growth and considerable personal, if not political, freedom. Organised dissent is non-existent, having been thoroughly crushed at Tiananmen Square 15 years ago. Within the ruling elite, there is no apparent appetite for even the most modest experimentation with political reform, such as holding democratic elections at county or municipal level, let alone permitting the creation of opposition parties.

China's Democratic Future: How It Will Happen and Where It Will Lead
By Bruce Gilley

Columbia University Press; 297 pages; $29.50 and £20.00

Buy it at
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Yet Bruce Gilley, in this fascinating book, starts from the opposite direction: that there is no compelling reason why China should not become democratic. That a single party should exercise a monopoly of political power indefinitely is, he reckons, if not an impossibility, then highly unlikely. The Communist Party in the old Soviet Union, like the PRI in Mexico, succumbed to old age at around 70. That would give the Chinese communists until 2019.

Elsewhere in Asia—in Indonesia, the Philippines, South Korea and Thailand—democracy has flowered, as it did first in southern and then in eastern Europe. In all these cases, reckons Mr Gilley, this had a lot to do with the emergence of a middle class, people who were entrepreneurial, well-connected to the outside world and increasingly fed up with being subject to the whims of rulers over whom they had no control. Such a class clearly already exists in China.

Mr Gilley has no patience with the line of argument—bafflingly common—which suggests that somehow the Chinese are unsuited to democracy. It is not just Taiwan that gives the counter-example: mainland China's own history is a narrative of chances almost taken, of good intentions hijacked or perverted. Mr Gilley rightly reminds us that, at the time of Tiananmen Square, things could easily have taken a different path. Powerful voices, including that of its then secretary-general, Zhao Ziyang, urged the party to steal the demonstrators' thunder by embracing democratic reform. It could have happened then and, Mr Gilley argues, it will happen sooner or later.

But when? That, Mr Gilley admits, is impossible to predict, though he favours the relatively (though not the very) near future. Beijing will host the Olympics in 2008: the Seoul Olympics in 1988 were a powerful catalyst for change in South Korea. In 2012 it will be the centenary of China's one and only national election to date. It would be a more than suitable occasion for another.

China's Democratic Future: How It Will Happen and Where It Will Lead.
By Bruce Gilley.
Columbia University Press; 297 pages; $29.50 and £20.00

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Michael Eisner

My life (deferred)

Jun 24th 2004 | SAN FRANCISCO
From The Economist print edition

What has happened to the boss of Disney's campfire memoirs?

Get article background

WHENEVER Larry Kirshbaum, the chairman of Warner Books, heard his friend Michael Eisner, the chief executive of the Walt Disney Company, talk about summer camp he was thrilled. Mr Eisner said that everything he knew about good management he had learned at Camp Keewaydin in Vermont in the 1950s. One day Mr Kirshbaum had a bright idea: Warner Books should publish an inspirational account of Mr Eisner's camp experiences and their application to modern business. Mr Kirshbaum himself would be Mr Eisner's editor. The two even visited Keewaydin on a sort of pilgrimage.

Mr Eisner has long entertained warm feelings about his camp, which he attended every summer from the age of seven until the rather advanced age of 22. In 2001, he told American National Public Radio that while it might sound “frivolous or even silly”, his experiences at summer camp had been “the most important part of my background.” Mr Kirshbaum later elaborated on his friend's remarks: “Michael is as passionate about Camp Keewaydin as he is about anything else in life or business,” he said. “This is going to be a very big book.”

Alas. Not yet. Publication of “Camp” was scheduled for Father's Day, June 20th, and Warner Books planned to print 100,000 copies. But the company decided at a late stage not to publish the book. A spokesperson insists that Mr Eisner's manuscript was received with uncomplicated enthusiasm: “But Michael simply doesn't have the time to promote it at the moment.” Officially, publication has been delayed until Father's Day 2005.

But within the closed world of New York publishing, rumours have circulated that “Camp” was not all Mr Kirshbaum had hoped it would be. One knowledgeable source says “the manuscript Eisner turned in was really boring. It was supposed to be more autobiographical, but it was all about sending your kids to camp. And who wants their kids to turn out like Michael Eisner?”

Mr Eisner, however, may have pulled the publication of “Camp” himself. Now is not the best time for Disney's chief executive to claim great management insights. On March 3rd this year, 43% of Disney's shareholders voted that they had no confidence in his leadership. Their dissatisfaction derives from several factors, including the loss of a key partner in animation, the falling quality of Disney products and Mr Eisner's much-resented regal manner. Shortly after the shareholders' meeting he stepped down as chairman while retaining the title of chief executive. It is now being suggested that he may shortly be replaced as CEO too. “Camp” might not have helped him at this delicate moment.

And what of the book's content? A speech that Mr Eisner delivered at the Tri-State Camping Conference in 2001 provides some hints of how the final product might have been. There he told the assembled camping professionals: “But, oh, the lessons I learned. On those canoe trips, we could never survive the first day if we didn't practise teamwork, show initiative, handle adversity, listen well and maintain a sense of humour. These attributes don't just apply to canoe trips. Years later, I found myself running an entire entertainment company. But much of the success I have achieved can be traced to the direct and metaphorical lessons I've learned in building campfires.” Who says Disney can't still offer good entertainment?

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Humour

A bucket of hydrangeas

Jun 24th 2004
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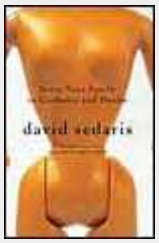
FOR the two weeks before Bill Clinton's “My Life” threatened to brush all aside, the top slot on the *New York Times* list of bestselling non-fiction was occupied by “Dress Your Family in Corduroy and Denim”. The first book in four years from David Sedaris, it could scarcely be more different from its successor. Mr Sedaris is one of the funniest writers alive; Mr Clinton is not.

Dress Your Family in Corduroy and Denim
By David Sedaris



Little, Brown; 272 pages; $24.95.
Abacus; £10.99

Buy it at
Amazon.com
Amazon.co.uk

Mr Sedaris, a short gay American (of Greek ancestry) who lives in France, rose to fame when he read on National Public Radio the “SantaLand Diaries”, a collection of short stories about his temporary employment as an elf clad in green tights at Macy's department store in New York. He went on (most famously) to write “Me Talk Pretty One Day”, and in 2001 received the Thurber prize for American humour.

It is four years since the publication of “Me Talk Pretty One Day”, during which time follow-up nerves have been steadily building among Mr Sedaris's now formidable cohort of fans. “Dress Your Family in Corduroy and Denim”—the title is never fully explained—does a good job of calming those nerves. Like a successful follow-up music album, it is keen not to replicate the exact formula that worked first time round, while at the same time resisting the temptation to veer off into the unrecognisable. It retains the perfect comic timing of Mr Sedaris's earlier work, but its tone has a more rounded feel. Though the pace may not be so pert, the curves sit well.

The last essay in the book recounts the story of being interrupted while killing a mouse—to put it out of its misery—at three in the morning by a small van-load of elderly Dutch holidaymakers. The tourists have got lost looking for a certain “willage” in the rural part of Normandy where Mr Sedaris and his boyfriend live. One of the tourists comes forward: “On hearing the faint, lapping noise, he squinted down into the bucket. ‘Oh,' he said. ‘I see that you have a little swimming mouse.' His tone did not invite explanation, and so I offered none. ‘My wife and I have a dog,' he continued. ‘But we did not bring it with us. Too much trouble'.”

The story gets more and more delightfully absurd, Mr Sedaris painting himself as a pervert-cum-psychopath with a dubious taste in interior decorating. It ends, however, on a note of life-affirming reflection. “When the sun came up I would bury my dead and fill the empty bucket with hydrangeas, a bit of life and colour, so perfect for the table. So pleasing to the eye.”

Mr Sedaris often uses moments of poignancy to provide respite from the laughter, much as a tragedian uses comic relief the other way round. In his latest book, however, these moments seem more serious; the poignancy has become sadder as the author has become a little older. Mr Sedaris once said in an interview that a review which criticised his work would point out that “the things I've written are obvious set-ups for jokes which don't work that well.” It is impossible to say such things about this book. Mr Sedaris's humour is dry, witty and consistently successful. Predictable and obvious it is not.

Dress Your Family in Corduroy and Denim.
By David Sedaris.
Little, Brown; 272 pages; $24.95.
Abacus; £10.99

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Children's books

The book of Esther

Jun 24th 2004
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IT IS immensely difficult to write a book for children, and even harder to sell one. The product itself must appeal both to parents (who go for gentle stories and useful lessons) and children (who like chaos and menace). Youthful tastes do not change much, so a good new text will struggle to compete with a great one from the 1950s, or even from the 18th century. How can anyone hope to succeed in such a market? One answer is to be an established author; another is to be an established celebrity.

Yakov and the Seven Thieves
By Madonna

Callaway Editions; 32 pages; $19.95.
Puffin; £12.99

Buy it at
Amazon.com
Amazon.co.uk

"Yakov and the Seven Thieves" is written by Madonna, an evergreen pop singer whose name appears 14 times on the cover and peripheral pages of the book. (The book's illustrator, by contrast, is mentioned only four times.) Were the text not to bear such a famous imprimatur—or that of Jamie Lee Curtis, Sarah Ferguson, Paul McCartney, or any of the other famous folk trying their hand at children's books—it would probably reside in what publishers dismally refer to as the "mid-list": worth publishing but not worth promoting. As it is, the book is to be released in more than 100 countries.

Madonna's third story for children is set in a vaguely pre-industrial world that will be familiar to readers of such tales. Yakov, the hero, is a cobbler with a sickly son. Failed by conventional medicine, he seeks help from the wise old man of the village. But even he is unsuccessful. Salvation then arrives in the form of Vladimir the Villain, Ivan the Arsonist et al, who are prevailed upon to pray for the child. Their efforts mysteriously "unlock the gates of heaven" and the little nipper is duly cured.

Needless to say, there is a message here. The wise old man's grandson, a rather effeminate youth with an intense spiritual curiosity, discovers that the rogues represent the wicked parts within us. By admitting and then renouncing such naughty tendencies, miracles can be accomplished. It is a more overtly religious message than is normally encountered in children's picture books, most of which (including this one) are published in Babylonian locales like London and New York. The inspiration comes from Kabbalah, a species of Jewish mysticism to which Madonna is famously devoted, and that has persuaded her to call herself Esther after a biblical queen. But the underlying idea, that the prayers of the poor are worth more than those of the wealthy, is pure medieval catholicism.

For all the ecumenical confusion, the message is heartfelt and the delivery straightforward. The material girl has a vivid and direct writing style—presumably the product of two decades of song-writing experience. Until the last few pages, when the moral of the tale is rather too clearly explained, the characters talk and behave like ordinary people.

Best of all is the art, by Gennady Spirin. Using a combination of pencil and colour washes, he creates an east European world of elaborate gables and snowy streets that adds just the right dose of fancy to the tale. Mr Spirin's name may not appear on the front cover of the book, but he is the real star of this performance.

Yakov and the Seven Thieves.
By Madonna.
Callaway Editions; 32 pages; $19.95.
Puffin; £12.99

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About sponsorship

Modern art

Basel and the brush

Jun 24th 2004 | BASEL
From The Economist print edition

The arbiter of contemporary taste

No risk? No reward?

FOR most of the year, the sleepy Swiss city of Basel sees nothing more exciting than a steady stream of central bankers on their way to the Bank for International Settlements. Except in early June, that is, when the place is invaded by a very unsteady flood of contemporary-art collectors rushing to the six-day Basel Art Fair. When the gates open on the first day, Nike-clad collectors literally sprint through the doors in pursuit of work by prized young artists. Some have been known to steal dealers' passes in order to sneak in early and get the pick of work that is newer and, in many cases, weirder than anyone else's.

By lunchtime on the first day, the VIP lounge is a scrum of hugely wealthy adrenaline jostling for food, puffing cigars and flashing digital images of art stored on Palm Pilots. According to a London dealer, David Juda, whose gallery was in at the founding of the fair, there has been a huge increase in interest in contemporary art since it began in 1970. “Today, people are more aware of what is happening in art and in museums,” he says. “They have more disposable income and they feel more at ease coming into a gallery than they would have, say, 30 years ago.” The fair is so successful that it is now held twice a year—once in Basel and once at Miami Beach (in December). This year 10,000 collectors flocked to the opening day, and over 50,000 attended during the week.

The draw is quality: Basel is the most strictly vetted modern-art fair in the world. A committee of international dealers selects each of the 270 galleries that attend on the basis of the quality and variety of their art. Stands are inspected daily, and dealers are encouraged to bring their best to Basel. It is possible to buy a Picasso or, if you're lucky, this century's Picasso. And that is part of the thrill: “It's like horse-racing,” says Mr Juda, “people only remember the bets that come in.”

Fancy a flutter on Finnbogi?

The fair is arranged on two floors: on the ground floor are the blue-chip art dealers such as Acquavella, Berggruen, Beyeler and Krugier. Upstairs are the more lively contemporary galleries where prices start at around €5,000 ($6,000), but can be as high as the £450,000 ($824,000) paid for Jake and Dinos Chapman's sculpture of a copulating couple. Down the road from the main fair is the “Liste”, where even trendier young galleries show work by emerging artists. Here collectors pounce as if they're in a bargain basement, sometimes snapping up entire stands at once.

Some collectors come to Basel with their personal curator to advise them. Others—such as Francesca von Habsburg—rely on their instincts. This year Ms von Habsburg paid €35,000 for a “sound installation” by an almost unknown Icelandic artist called Finnbogi Petursson because she loved the work: “It makes sound visible,” she says. The room-sized piece will go to Ms von Habsburg's new Vienna-based art foundation, dedicated to showing 21st-century art. Scion of a family famous for collecting old masters, Ms von Habsburg took a punt on Mr Petursson's work knowing that the Reykjavik gallery exhibiting it had launched the career of another Icelandic artist, Olafur Eliasson, who is now a star in the contemporary-art world.

Most collectors start by decorating their own houses. Frank Cohen, a Manchester millionaire, bought his first painting to furnish his home 30 years ago. But his interest has spiralled so much that next year he is opening a museum of contemporary art in Manchester to house his vast collection. An Argentine

pharmaceuticals tycoon, Juan Verges, and his wife have been coming to Basel for eight years and have amassed such an immense collection of large-scale installations that they have restored a factory in Buenos Aires to exhibit them all. For Mr Verges, as for most collectors, buying new art allows him to get to know artists and to watch the creative process at first hand.

But not all buyers are wide-eyed enthusiasts with little concern for the future value of their purchases. Joao Reindeiro, president of Banco Privado Portugues, believes that contemporary art is a good investment. He sees it as a “risky asset class”, but one that has earned returns of 10-12% per annum over the past 17 years.

Collectors who want to keep an eye on the value of their art can turn to the Gabrius Index for help. Set up by William Goetzmann, a professor of finance at the Yale School of Management, it charts changes in the price of art that has been auctioned more than once. Mr Goetzmann says that contemporary art is like a “high beta” stock: one that rises and falls faster than others.

Last year, the sub-index of abstract contemporary art prices rose by 97%, a rate not seen since 1991. Does this presage a bubble similar to that of the late 1980s, when prices doubled almost every six months? Not yet, says Mr Goetzmann: “We are seeing the first flush of enthusiasm rather than a boom.” The sober-minded at Basel (a minority) noted that at the end of 2002 the abstract-art index stood at almost exactly the same level as a decade earlier.

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Obituary

Ulrich Inderbinen

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From The Economist print edition

Corbis

Ulrich Inderbinen, the world's oldest mountain guide, died on June 14th, aged 103

THE Matterhorn in Switzerland, with its bent, jagged peak and steep glacial ridges, is frequently climbed these days. As on many popular yet difficult mountains, ropes and ladders are fixed permanently into the rock and ice, and huts line the route to the summit. But the Matterhorn has long had a reputation for deadliness—half the members of the first group to climb it, in 1865, perished on the descent—and it remains one of the world's most dangerous peaks. Crowds make it more so, as novice climbers are tempted by its fame.

This awesome mountain was a hugely important place in Ulrich Inderbinen's life. He was born in 1900 in Zermatt, at the mountain's foot: a remote village of only 750 people, with tourism a small but burgeoning industry. Mr Inderbinen rarely left the region of his birth, and was 20 before he took the train to the nearest town. To make up for it, he climbed out of the valley quite often—almost daily for nearly 70 years. He scaled all 14,700 feet of the Matterhorn more than 370 times, though he is said to have lost track of the exact number.

Mr Inderbinen thought the Matterhorn “the most beautiful mountain in the world”. Although it was only one of many mountains he climbed over the course of the 20th century, guiding innumerable clients up and down with inexhaustible good cheer, no other so engrossed him. On his first ascent, at the age of 20, he went with his sister Martha and a friend of hers. The girls wore long skirts and their ordinary shoes, and the lanterns they were carrying kept blowing out. Since none of them knew the route, they followed scratch-marks made by previous climbers on the rocks. On his last ascent, bent double under his ropes at the age of almost 90, he conquered the mountain in four hours.

Mr Inderbinen met life with the same equanimity as the mountains, his dry wit punctuating his monumental energy. When asked if he ever got bored, climbing the same peaks again and again, he replied, “Only when the clients walk too slowly.” When one journalist pointed out an enthusiastic review from an American client in the 1930s, Mr Inderbinen replied: “Perhaps he did not know any other guides.”

But rivalry was by no means absent from Mr Inderbinen's life. As a young guide, he would walk for four hours each morning to catch visitors disembarking from the train above Zermatt. He took up ski-racing

at 82 when he realised that, with no other competitors in his age-group, he could win every race—which he did. Until almost the end of the century he continued to take climbers up easier local peaks, proving to other guides how sure he still was. For his 95th birthday he was given an ice-axe as a present, which he put to good use. One of his few regrets was his family's veto of an attempt to climb Mount Kilimanjaro, the tallest mountain in Africa, when he was 92.

On larch-wood skis

Mr Inderbinen might have been a farmer like his parents. Much of his early life was spent herding cows and picking edelweiss for tourists. He did not get his first skis, made from local larch, until he was 20. But he eventually chose mountain-guiding in emulation of his uncle Moritz, a famous guide when Mr Inderbinen was a child.

At first, business was slow. Between customers, Mr Inderbinen had to cut trees and shovel snow. Then came the second world war, with no visitors at all. For a while Mr Inderbinen served in the ski patrol of the Swiss army. He would glide in the mountains above Zermatt, often alone and often at night, forbidden even to switch on a torch. Whether or not he truly helped the war effort, it was a billet that suited him exactly.

His chosen profession allowed for a bit more camaraderie in peacetime. Indeed, the profession of a guide entailed a paradoxical combination of solitude amongst the high glaciers and sociability among his fellow mountaineers. And once visitors poured back to Zermatt, he began to be in demand. Unusually in the climbing business, he sought fame through service—guiding others safely up mountains, rather than conquering them for himself.

Mr Inderbinen's life was notably harmonious. He had no car, telephone or even bicycle, and chopped his own firewood deep into old age. He made his living on his feet or his skis, proceeding steadily; he did not believe, he said, in doing anything hastily, on the slopes or elsewhere. (This, however, was not always true; he gave up mountain-guiding, at 97, when he realised he had taken ten minutes longer than he should have done to decend the Breithorn.) He built his house with his own hands, finishing it in 1935, and lived in it for the rest of his life. He knew what he wanted, and had it close by. Especially, he wanted those particular mountains.

George Mallory, a British mountaineer who tried to conquer Everest and died on it, famously said he wanted to climb the peak “because it is there.” Mallory crystallised a romantic vision of the mountaineer, chasing after dreams on ice-wrapped summits far from home and hearth. Ulrich Inderbinen could not have been more different. He went up mountains not because they were there, but because he was. He died gently, in his bed. And though he may not have been the first to climb the Matterhorn, he seems to have climbed it best.

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Overview

Jun 24th 2004
From The Economist print edition

America's current-account deficit widened sharply in the first three months of 2004 to $144.9 billion. The deficit reached 5.1% of GDP, up from 4.5% in the fourth quarter of 2003. More than half the increase was because of a worsening goods deficit, thanks in large part to higher oil prices, but also thanks to strong domestic demand. America's surplus on its investment income also fell, from $17.5 billion in the fourth quarter of 2003 to $14.1 billion.

In a further sign that inflation is picking up, producer prices in America rose by 0.8% in May and by 4.9% in the 12 months to May. That was more than analysts were expecting and the fastest monthly rise in more than a year. Excluding the volatile categories of food and energy, core producer prices rose by 0.3% in May and by 1.7% in the 12 months to May.

Inflation in **Canada** is also on the rise. Consumer prices rose by 2.5% in the year to May, up from 1.6% in the year to April, driven largely by higher fuel costs. Petrol prices were up 30.3% in the 12 months to May. Core inflation was tame, however, rising only 1.5% in the year to May.

Despite higher interest rates, **British** consumers are showing little sign of closing their wallets. With employment high and wage growth speeding up, retail sales rose 7.4% in the year to May, the fastest pace since April 2002. Property prices also continued to rise.

Retail sales in **Italy**, in contrast, remain lacklustre, rising only 0.2% in April after declining in February and March on a monthly basis. In the year to April, retail sales rose a mere 0.8%.

Investor confidence in **Germany** rose for the first time this year, according to the ZEW institute's measure of economic sentiment. The economic-expectations index rose to 47.4 in June from 46.4 in May. Nonetheless, the improvement was modest and the index still remains well below its levels at the end of 2003.

German consumers are also subdued. Retail sales in April fell by 1.8%, compared with a 1% rise across the euro area as a whole.

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Output, demand and jobs

Jun 24th 2004
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2004	2005	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 3.2	Q1	+ 0.9	+ 3.8	+ 3.1	– 0.9	Q4	+ 7.7	Q1	5.5	May	6.1
Austria	+ 0.8	Q4	+ 0.4	+ 1.6	+ 1.9	+ 2.1	Mar	+ 2.6	Mar	4.4	May	4.4
Belgium	+ 2.0	Q1	+ 3.0	+ 1.9	+ 2.0	– 1.0	Apr	nil	Mar	12.3	May†	11.4
Britain	+ 3.0	Q1	+ 2.5	+ 3.1	+ 2.6	+ 0.5	Apr	+ 7.4	May	4.8	Apr††	5.1
Canada	+ 1.6	Q1	+ 2.4	+ 2.8	+ 3.3	+ 1.9	Mar	+ 4.9	Mar	7.2	May	7.9
Denmark	+ 1.3	Q1	+ 2.3	+ 2.0	+ 2.2	+ 3.3	Apr	+ 5.3	Apr	6.5	Apr	5.9
France	+ 1.7	Q1	+ 3.1	+ 2.1	+ 2.2	+ 1.1	Apr	+ 2.7	Apr	9.8	Apr	9.6
Germany	+ 1.5	Q1	+ 1.8	+ 1.4	+ 1.7	+ 2.2	Apr	– 1.8	Apr	10.5	May§	10.7
Italy	+ 0.8	Q1	+ 1.8	+ 1.1	+ 1.7	+ 0.2	Apr	– 2.7	Mar	8.5	Jan	8.9
Japan	+ 5.6	Q1	+ 6.1	+ 4.1	+ 2.1	+ 8.7	Apr	– 0.5	Apr	4.7	Apr	5.4
Netherlands	+ 0.8	Q1	+ 1.7	+ 1.1	+ 1.7	+ 1.1	Apr	– 2.3	Mar‡	6.4	Apr**	4.9
Spain	+ 2.8	Q1	+ 2.6	+ 2.8	+ 2.8	+ 0.9	Apr	+ 4.3	Apr	11.2	Apr	11.3
Sweden	+ 2.6	Q1	+ 2.6	+ 2.5	+ 2.5	+ 4.3	Apr	+ 3.5	Apr	5.3	May†	4.2
Switzerland	+ 1.5	Q1	+ 1.6	+ 1.7	+ 1.9	+ 4.5	Q1	+ 1.6	Apr	3.8	May†	3.6
United States	+ 5.0	Q1	+ 4.4	+ 4.7	+ 3.6	+ 6.3	May	+ 8.5	Apr	5.6	May	6.1
Euro area	+ 1.3	Q1	+ 2.3	+ 1.7	+ 2.0	+ 1.7	Apr	+ 1.0	Apr	9.0	Apr	8.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 2.7	Q1	+ 3.0	na	na	+ 0.7	Apr	+ 4.8	Mar	11.6	May†	11.4
Greece	+ 4.0	Q1	+ 3.0	na	na	+ 1.8	Apr	+ 5.4	Mar	na		na
Iceland	+ 4.9	Q1	na	na	na	na		na		3.5	Apr†	3.9
Ireland	+ 2.7	Q4	na	na	na	+ 4.0	Apr	+ 5.0	Mar	4.5	May	4.4
Luxembourg	+ 2.12003		na	na	na	– 1.2	Dec	+ 0.1	Jan	4.3	Apr	3.6
New Zealand	+ 3.2	Q4	+ 2.4	na	na	+ 3.2	Q4	+ 8.0	Q1	4.3	Q1	4.9
Norway	+ 2.9	Q1	+ 3.9	na	na	+ 0.7	Apr	+ 2.1	Apr	4.5	Q1	4.4
Portugal	+ 0.1	Q1	+ 2.4	na	na	– 3.2	Apr	+ 3.6	Apr	6.4	Q1†	6.4

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡New series. ††Feb-Apr; claimant count rate 2.8% in May. §EU harmonised rate 9.8% in May. **Feb-Apr.

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Prices and wages

Jun 24th 2004
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2004	2005	latest		year ago	latest		year ago
Australia	+ 2.0	Q1	+ 3.4	+ 2.3	+ 2.6	– 1.1	Q1	+ 3.0	+ 5.1	Q1	+ 4.4
Austria	+ 2.1	May	+ 1.1	+ 1.5	+ 1.5	+ 6.1	May	+ 0.6	+ 2.2	Apr	+ 2.2
Belgium	+ 2.6	May	+ 1.0	+ 1.5	+ 1.5	+ 3.9	May	– 0.4	+ 2.3	Apr	+ 1.7
Britain	+ 1.5	May*	+ 1.2	+ 1.5	+ 1.8	+ 2.4	May	+ 1.1	+ 4.3	Apr†	+ 3.2
Canada	+ 2.5	May	+ 2.9	+ 1.6	+ 2.0	+ 1.5	Apr	– 0.5	+ 3.0	Mar	+ 1.6
Denmark	+ 1.3	May	+ 2.2	+ 1.4	+ 2.0	+ 2.8	May	– 0.6	+ 3.3	Q1	+ 3.9
France	+ 2.6	May	+ 1.8	+ 2.0	+ 1.6	+ 1.3	Apr	+ 1.0	+ 2.8	Q1	+ 2.9
Germany	+ 2.0	May	+ 0.7	+ 1.4	+ 1.2	+ 3.6	May	– 0.4	+ 1.1	Apr	+ 3.3
Italy	+ 2.3	May	+ 2.7	+ 2.2	+ 2.1	+ 1.7	Apr	+ 2.0	+ 2.8	Apr	+ 1.7
Japan	– 0.4	Apr	– 0.1	– 0.1	+ 0.1	+ 1.1	May	– 1.1	+ 0.7	Apr	+ 1.8
Netherlands	+ 1.5	May	+ 2.0	+ 1.4	+ 1.3	+ 2.1	Apr	+ 1.4	+ 1.6	May	+ 3.0
Spain	+ 3.4	May	+ 2.7	+ 2.6	+ 2.6	+ 2.6	Apr	+ 1.4	+ 3.2	Q1	+ 4.9
Sweden	+ 0.7	May	+ 1.9	+ 0.8	+ 1.6	+ 1.2	May	– 1.4	+ 1.5	Mar	+ 1.5
Switzerland	+ 0.9	May	+ 0.4	+ 0.4	+ 0.9	+ 0.7	Apr	– 0.3	+ 1.4	2003	+ 1.8
United States	+ 3.1	May	+ 2.1	+ 2.3	+ 2.0	+ 4.9	May	+ 2.4	+ 2.2	May	+ 3.0
Euro area	+ 2.5	May	+ 1.8	+ 1.8	+ 1.7	+ 1.4	Apr	+ 1.7	+ 2.3	Q1	+ 3.0
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	– 0.1	May	+ 0.7	na	na	+ 1.6	May	– 0.7	+ 4.1	Q1	+ 4.1
Greece	+ 2.9	May	+ 3.8	na	na	+ 2.8	Apr	+ 1.0	na		na
Iceland	+ 3.9	Jun	+ 1.8	na	na	+ 5.0	May	+ 3.0	+ 4.6	May	+ 5.6
Ireland	+ 1.7	May	+ 3.7	na	na	– 4.1	Apr	– 7.5	+ 6.1	Q4	+ 6.4
Luxembourg	+ 2.3	May	+ 1.9	na	na	+ 2.3	Mar	+ 2.6	– 0.4	Dec	+ 0.7
New Zealand	+ 1.5	Q1	+ 2.5	na	na	– 0.6	Q1	– 1.3	+ 2.2	Q1	+ 2.3
Norway	+ 1.0	May	+ 2.1	na	na	+18.8	May	– 4.5	+ 4.6	Q1	+ 5.3
Portugal	+ 2.4	May	+ 3.7	na	na	+ 1.8	May	+ 1.1	+ 2.6	Mar	– 2.6

*New series. RPI inflation rate in May: 2.8%. †Feb-Apr.

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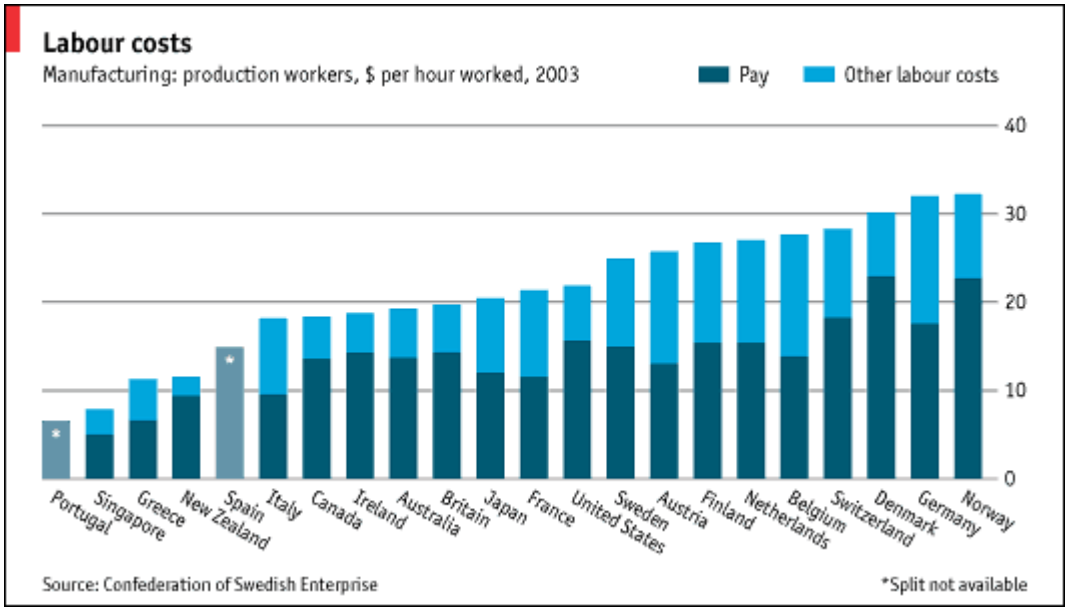
Labour costs

Jun 24th 2004
From The Economist print edition



Total labour costs per worker are especially high in several European countries. However, much of the burden on employers arises not from pay, but from hefty social-insurance contributions. The pay rates of German workers, for example, are only a bit higher than those of American employees. But the total labour costs per worker in Germany are much higher than those in America.

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Money and interest rates

Jun 24th 2004
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Jun 23rd 2004)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 7.0	+11.0	Apr	5.48	4.62	5.18	5.90	4.73	6.66
Britain	+ 5.2	+ 7.9	May	4.78	3.63	4.87	5.15	4.06	5.90
Canada	+12.4	+ 8.6	May	2.01	3.03	3.32	5.23	4.42	6.41
Denmark	+ 7.9	+ 9.0	May	2.30	2.25	2.67	4.47	3.81	5.51
Japan	+ 4.2	+ 2.0	May	0.02	0.01	0.20	1.87	0.63	1.93
Sweden	+ 0.3	+ 3.2	Apr	1.97	2.71	3.00	4.62	4.07	3.09
Switzerland	+ 9.4	+ 4.3	May	0.47	0.28	1.33	2.85	2.37	2.69
United States	+ 5.1	+ 5.5	May	1.40	0.88	2.74	4.70	3.35	6.11
Euro area†	+10.9	+ 5.6	Apr	2.12	2.15	2.68	4.31	3.61	4.15

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 5.38%, Japan No. 260 1.86%. Central bank rates: US fed funds 1.00%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 4.50%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Jun 24th 2004
From The Economist print edition

1995=100

	Jun 15th	Jun 22nd*	% change on one month	% change on one year
Dollar index				
All items	93.8	94.2	– 1.9	+22.9
Food	92.1	91.8	– 2.7	+19.8
Industrials				
All	96.0	97.4	– 0.9	+27.1
Nfa†	94.2	92.3	– 4.2	+13.3
Metals	97.6	101.6	+ 1.7	+40.2
Sterling index				
All items	81.3	81.6	– 2.5	+12.4
Euro index				
All items	102.1	102.5	– 1.8	+17.1
Yen index				
All items	109.8	109.3	– 4.8	+13.7
Gold				
$ per oz	386.50	396.00	+ 2.1	+13.9
West Texas Intermediate				
$ per barrel	37.14	38.03	– 7.6	+32.6

* Provisional. † Non-food agriculturals.

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Stockmarkets

Jun 24th 2004
From The Economist print edition

Market indices

	Jun 23rd	2004 high	2004 low	% change on one week	% change on record high	% change on Dec 31st 2003 in local currency	% change on Dec 31st 2003 in $ terms
Australia (All Ordinaries)	3,545.3	3,547.4	3,274.9	+ 1.7	– 0.1	+ 7.2	– 2.1
Austria (ATX)	1,953.4	1,985.9	1,568.9	+ 2.0	– 1.6	+26.4	+21.2
Belgium (Bel 20)	2,450.9	2,517.3	2,244.2	nil	–33.4	+ 9.2	+ 4.7
Britain (FTSE 100)	4,486.7	4,575.7	4,309.4	– 0.1	–35.3	+ 0.2	+ 1.9
Canada (Toronto Composite)	8,575.4	8,898.8	8,123.5	+ 1.8	–24.7	+ 4.3	– 1.0
Denmark (KBX)	236.2	241.3	219.0	+ 1.6	–21.7	+10.6	+ 6.2
France (SBF 250)	2,531.5	2,594.4	2,411.5	+ 0.3	–42.3	+ 5.0	+ 0.6
(CAC 40)	3,720.1	3,811.4	3,465.3	+ 0.2	–46.3	+ 4.6	+ 0.2
Germany (DAX)	3,945.1	4,151.8	3,726.1	– 1.5	–51.1	– 0.5	– 4.6
Italy (BCI)	1,318.1	1,340.3	1,239.5	– 0.4	–39.6	+ 4.9	+ 0.5
Japan (Nikkei 225)	11,580.6	12,163.9	10,365.4	– 0.5	–70.2	+ 8.5	+ 7.0
(Topix)	1,156.2	1,217.9	1,022.6	– 0.9	–59.9	+10.8	+ 9.3
Netherlands (AEX)	340.4	364.8	323.0	– 0.5	–51.5	+ 0.8	– 3.4
Spain (Madrid SE)	852.5	881.7	808.0	+ 0.5	–25.6	+ 5.5	+ 1.1
Sweden (Affarsvarlden Gen)	203.8	218.1	188.5	+ 0.5	–49.1	+ 8.2	+ 2.5
Switzerland (Swiss Market)	5,653.9	5,934.4	5,469.0	– 1.0	–32.8	+ 3.0	+ 1.7
United States (DJIA)	10,479.6	10,737.7	9,906.9	+ 1.0	–10.6	+ 0.2	+ 0.2
(S&P 500)	1,144.1	1,157.8	1,084.1	+ 0.9	–25.1	+ 2.9	+ 2.9
(NASDAQ Comp)	2,021.0	2,153.8	1,876.6	+ 1.1	–60.0	+ 0.9	+ 0.9
Europe (FTSE Eurotop 300)*	1,000.5	1,026.2	957.9	– 0.7	–41.3	+ 4.4	+ 0.1
Euro area (FTSE Ebloc 100)*	846.1	888.3	806.7	– 0.4	–45.4	+ 1.7	– 2.5
World (MSCI)†	1,059.5	1,085.8	997.0	+ 0.7	–26.9	+ 2.2	+ 2.2
World bond market (Citigroup)‡	591.0	619.5	575.1	+ 0.8	– 4.6	– 2.1	– 2.1

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Jun 24th 2004
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		The Economist poll % of GDP, forecast 2004	2005	Exchange rate trade-weighted† 1990=100 Jun 23rd	year ago	Currency units per $ Jun 23rd	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2004‡
Australia	− 16.8	Apr	− 33.0	Q1	− 5.2	− 4.5	81.6	83.5	1.45	1.49	2.65	1.76	1.34	0.5
Austria	− 0.8	Mar	− 1.4	Apr	+ 0.4	+ 0.5	102.8§	102.3	0.83	0.86	1.50	–	0.76	-1.3
Belgium	+ 21.8	Apr	+ 8.0	Dec	+ 3.9	+ 3.9	102.7§	102.2	0.83	0.86	1.50	–	0.76	-0.2
Britain	− 89.4	Apr	− 30.8	Q4	− 2.6	− 2.6	105.6	101.1	0.55	0.60	–	0.66	0.51	-2.9
Canada	+ 47.8	Apr	+ 20.9	Q1	+ 1.8	+ 1.3	84.7	86.8	1.36	1.34	2.48	1.65	1.25	1.2
Denmark	+ 9.2	Apr	+ 6.4	Apr	+ 2.5	+ 2.5	106.2	106.5	6.15	6.42	11.2	7.43	5.66	0.9
France	+ 4.6	Apr	+ 10.5	Apr	+ 0.9	+ 0.8	106.1§	105.4	0.83	0.86	1.50	–	0.76	-3.8
Germany	+174.2	Apr	+ 74.3	Apr	+ 2.6	+ 2.6	103.8§	102.9	0.83	0.86	1.50	–	0.76	-3.7
Italy	+ 2.6	Apr	− 16.2	Apr	− 1.0	− 0.9	75.7§	75.1	0.83	0.86	1.50	–	0.76	-3.1
Japan	+121.4	Apr	+157.2	Apr	+ 3.3	+ 3.3	136.1	128.5	109	118	198	131	–	-7.1
Netherlands	+ 33.1	Apr	+ 18.7	Q1	+ 2.6	+ 2.7	102.1§	101.6	0.83	0.86	1.50	–	0.76	-3.1
Spain	− 56.5	Mar	− 27.0	Mar	− 2.9	− 3.0	76.9§	76.6	0.83	0.86	1.50	–	0.76	0.3
Sweden	+ 21.7	May	+ 21.2	Q1	+ 5.9	+ 5.6	80.5	80.6	7.59	7.93	13.8	9.18	6.99	0.2
Switzerland	+ 7.9	May	+ 32.8	Q4	+10.6	+10.3	114.1	112.7	1.25	1.33	2.28	1.52	1.15	-1.6
United States	−568.9	Apr	−537.3	Q1	− 5.1	− 5.1	97.5	101.9	–	–	1.82	1.21	0.92	-4.7
Euro area	+103.0	Apr	+ 47.6	Mar	+ 0.4	+ 0.4	89.6	90.1	0.83	0.86	1.50	–	0.76	-2.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 14.8	Apr	+ 11.2	Apr	na	na	81.7§	81.1	0.83	0.86	1.51	–	0.76	1.6
Greece	− 27.2	Apr	− 10.4	Apr	na	na	59.4§	59.1	0.83	0.86	1.51	–	0.76	-3.2
Iceland	− 0.3	Apr	− 0.7	Q1	na	na	96.5**	97.2	72.7	76.1	132	87.9	66.9	0.2
Ireland	+ 42.8	Mar	− 3.0	Q4	na	na	93.6§	93.4	0.83	0.86	1.51	–	0.76	-0.5
Luxembourg	− 3.7	Mar	+ 2.5	Q4	na	na	102.7§	102.2	0.83	0.86	1.51	–	0.76	-1.8
New Zealand	− 2.4	Apr	− 3.4	Q1	na	na	100.3	98.6	1.60	1.70	2.91	1.93	1.47	2.9
Norway	+ 28.6	May	+ 28.9	Mar	na	na	95.7	97.1	6.93	7.14	12.6	8.38	6.38	10.4
Portugal	− 14.4	Mar	− 8.3	Apr	na	na	93.6**	92.7	0.83	0.86	1.51	–	0.76	-3.8

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, April average. ‡OECD forecast. **IMF, March average.

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Trade

Jun 24th 2004
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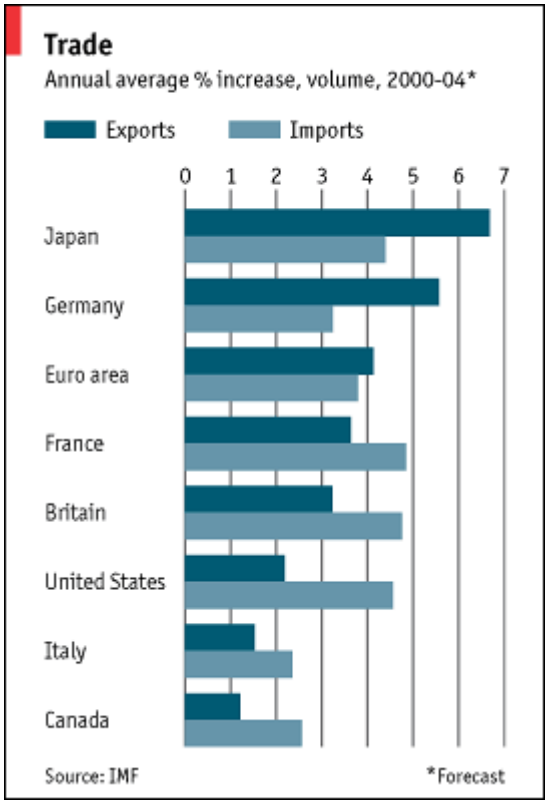

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Overview

Jun 24th 2004
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Industrial output fell by 6.6% in **Poland** in May, dragging the 12-month rate down from 21.8% in April to 12.3%.

Turkey ran a trade deficit of $3 billion in April, raising the 12-month deficit from $25.3 billion to $26.8 billion.

Brazil ran a current-account surplus of $1.5 billion in May, raising the 12-month surplus to $6.5 billion.

Argentina continues to recover strongly. GDP rose by 10.7% in the year to the first quarter.

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South Korea

Jun 24th 2004
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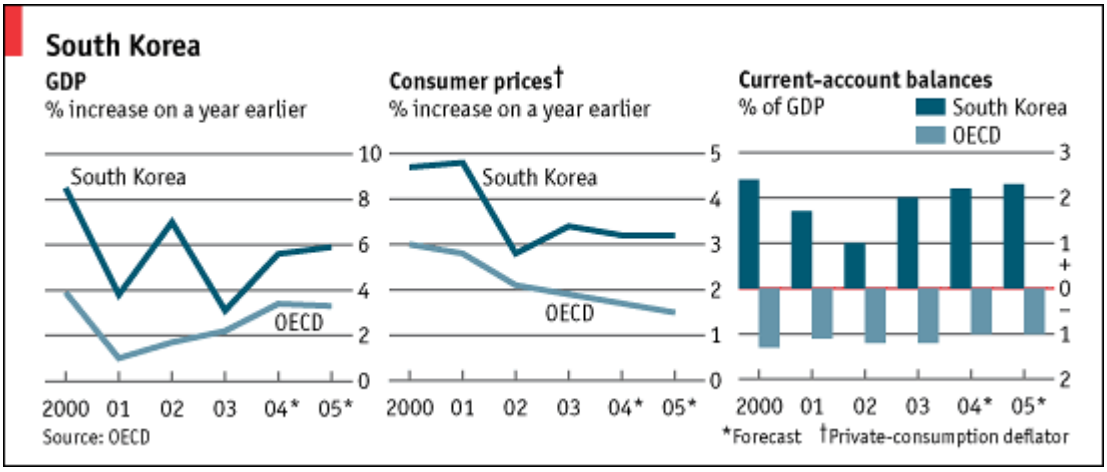

After a setback in 2003, South Korea is recovering sharply, and GDP is forecast to grow by nearly 6% a year in 2004 and 2005. The economy has been boosted by rapid growth in China, which has become its biggest trading partner. The export sector, buoyed also by the upturn in world trade, will be the main engine of growth in 2004. Next year, the baton will pass to consumer spending and investment. The OECD says that the supply side of the economy needs more competition in order to foster productivity gains.

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Economy

Jun 24th 2004
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	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.8	Q1	+17.5	May	+ 4.4	May	+15.6	May	+45.9	2003	444.4	Mar
Hong Kong	+ 6.8	Q1	+ 1.8	Q1	– 0.9	May	–11.4	Apr	+17.4	Q4	120.1	May
India	+10.4	Q4	+ 9.4	Apr	+ 2.2	Apr	–16.4	May	+ 3.2	Q4	114.3	May
Indonesia	+ 4.5	Q1	+ 5.1	Jan	+ 6.5	May	+27.9	Apr	+ 7.4	Q4	35.9	Apr
Malaysia	+ 7.6	Q1	+14.0	Apr	+ 1.2	May	+20.4	Apr	+12.3	Q4	53.9	May
Philippines	+ 6.4	Q1	–11.0	Mar	+ 4.5	May	– 1.7	Apr	+ 3.3	Dec	13.3	May
Singapore	+ 7.5	Q1	+22.2	Apr	+ 2.0	May	+15.1	May	+27.6	Q1	101.1	May
South Korea	+ 5.3	Q1	+11.3	Apr	+ 3.3	May	+26.5	May	+21.9	Apr	163.6	Apr
Taiwan	+ 6.3	Q1	+12.8	Apr	+ 0.9	May	+14.6	May	+27.4	Q1	229.0	May
Thailand	+ 6.5	Q1	+ 7.7	Apr	+ 2.4	May	+ 2.8	Apr	+ 7.5	Apr	41.6	Apr
Argentina	+10.7	Q1	+ 6.0	Apr	+ 4.3	May	+14.4	Apr	+ 7.9	Q4	16.7	May
Brazil	+ 2.7	Q1	+ 6.7	Apr	+ 5.2	May	+28.0	May	+ 6.5	May	50.5	Apr
Chile	+ 4.8	Q1	+ 4.9	Apr	+ 0.6	May	+ 5.8	May	– 0.1	Q1	16.0	May
Colombia	+ 3.8	Q1	+ 7.1	Mar	+ 5.4	May	+ 0.1	Mar	– 1.4	Q4	11.3	Apr
Mexico	+ 3.7	Q1	+ 4.0	Apr	+ 4.3	May	– 5.4	May	– 9.1	Q1	60.3	Apr
Peru	+ 3.3	Apr	+ 7.9	Mar	+ 3.2	May	+ 1.4	Apr	– 0.6	Q1	10.1	Apr
Venezuela	+29.8	Q1	+43.2	Mar	+21.8	May	+17.8	Q1	+12.3	Q1	17.8	Mar
Egypt	+ 3.1	2003†	+ 2.6	2003†	+ 5.5	Dec	– 6.0	Q4	+ 3.9	Q4	13.6	Feb
Israel	+ 2.6	Q1	+10.9	Mar	– 0.6	May	– 5.9	May	+ 0.3	Q1	26.6	May
South Africa	+ 1.9	Q1	+ 2.9	Apr	+ 0.6	May	+ 1.5	Apr	– 1.5	Q4	8.9	May
Turkey	+ 6.1	Q4	+16.5	Apr	+ 8.9	May	–26.8	Apr	– 9.0	Mar	33.7	Apr
Czech Republic	+ 3.1	Q1	+10.1	Apr	+ 2.7	May	– 2.5	Apr	– 6.0	Q1	26.4	May
Hungary	+ 4.2	Q1	+ 9.4	Apr	+ 7.6	May	– 4.2	Apr	– 7.1	Apr	13.1	May
Poland	+ 6.9	Q1	+12.3	May	+ 3.4	May	– 6.0	Apr	– 2.9	Mar	34.3	Apr
Russia	+ 7.4	Q1	+ 5.5	May	+10.2	May	+65.7	Apr	+35.3	Q1	81.8	May
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+ 6.8	Q1	+ 4.1	Apr	+ 3.7	May	– 2.2	Apr	– 1.1	Q1	1.3	Apr
Latvia	+ 8.8	Q1	+ 9.4	Apr	+ 6.2	May	– 2.3	Apr	– 1.3	Apr	1.7	Apr
Lithuania	+ 7.7	Q1	na		+ 1.1	May	– 2.9	Apr	– 1.2	Q4	3.3	Apr
Slovakia	+ 5.5	Q1	+ 5.7	May	+ 8.3	May	– 0.4	Apr	nil	Mar	11.6	Apr
Slovenia	+ 3.7	Q1	– 0.9	Apr	+ 3.8	May	– 0.9	Apr‡	– 0.1	Apr	8.3	Mar
Pakistan	+ 5.1	2003†	+13.4	Feb	+ 7.1	May	– 2.7	May	+ 2.4	Q1†	11.1	May
Saudi Arabia	+ 6.4	2003	na		+ 0.3	Mar	+50.2	2003	+29.7	2003	22.1	Apr

*Excluding gold, except Singapore; IMF definition. †Year ending June.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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Financial markets

Jun 24th 2004
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Jun 23rd		Dec 31st 2003	
	Jun 23rd	year ago	Jun 23rd	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	15.1	3.60	1,513.1	– 2.4	– 3.6	– 3.6
Hong Kong	7.80	7.80	14.2	0.55	11,849.8	– 2.6	– 5.8	– 6.2
India	45.7	46.5	83.1	4.41	4,644.0	– 3.0	– 20.5	– 20.6
Indonesia	9,423	8,223	17,143	7.53	699.8	– 1.1	+ 1.1	– 9.6
Malaysia	3.80	3.80	6.91	2.90	882.1	+ 7.8	+ 11.1	+ 11.1
Philippines	56.2	53.3	102.3	7.94	1,573.5	+ 1.9	+ 9.1	+ 7.7
Singapore	1.72	1.74	3.13	0.78	1,794.7	– 2.0	+ 1.7	+ 0.4
South Korea	1,160	1,187	2,109	3.93	738.9	– 1.8	– 8.9	– 6.3
Taiwan	33.8	34.5	61.4	1.10	5,729.3	+ 3.0	– 2.7	– 2.2
Thailand	41.0	41.5	74.6	1.29	627.2	+ 0.5	– 18.8	– 21.5
Argentina	2.95	2.76	5.36	5.44	960.9	+ 5.7	– 10.4	– 10.9
Brazil	3.13	2.85	5.69	15.82	20,836.1	+ 1.8	– 6.3	– 13.5
Chile	643	704	1,170	1.80	7,438.3	+ 0.9	+ 1.4	– 6.5
Colombia	2,716	2,808	4,942	7.90	2,982.5	– 3.2	+ 27.8	+ 30.8
Mexico	11.3	10.5	20.6	6.58	10,137.9	– 0.1	+ 15.3	+ 14.2
Peru	3.47	3.48	6.31	2.46	2,848.7	– 0.7	+ 17.0	+ 16.8
Venezuela	2,701§	1,598	4,914	13.97	25,611.2	+ 3.9	+ 15.3	+ 21.8
Egypt	6.22	5.99	11.32	11.15	13,941.4	– 3.8	+ 19.8	+ 18.7
Israel	4.51	4.36	8.21	1.00	590.5	+ 2.4	+ 10.5	+ 7.7
South Africa	6.25	7.70	11.4	8.20	9,982.1	– 1.2	– 3.9	+ 2.6
Turkey	1,494,300	1,435,500	2,718,580	25.26	16,820.0	– 1.6	– 9.7	– 15.1
Czech Republic	26.4	27.2	48.0	2.31	805.1	+ 2.2	+ 22.2	+ 18.9
Hungary	210	226	382	11.57	11,346.7	+ 1.4	+ 21.0	+ 19.6
Poland	3.77	3.87	6.86	5.92	23,569.8	+ 1.6	+ 13.2	+ 12.4
Russia	29.0	30.3	52.8	13.00	603.1‡	+13.1	+ 5.5	+ 6.3
EMF (MSCI)*	1.00	1.00	1.82	na	420.3	+ 1.3	– 5.1	– 5.1
EMBI+†	1.00	1.00	1.82	na	286.6	+ 1.2	– 2.8	– 2.8

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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